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Non-Profit Organizations as Investor Protection: Economic Theory, and Evidence from East Asia

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Nonprofit Organizations as Investor Protection: Economic Theory and Evidence from East Asia

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I. INTRODUCTION

Enforcement problems plague shareholder activism and investor protection efforts in many parts of the world. These problems are particularly severe in transition economies, where weaknesses in legal and market constraints are prevalent. The importance of solving this problem has led legal scholars to consider a range of partial alternative solutions to domestic enforcement regimes. For example, Bernard Black and Reinier Kraakman devised a “self-enforcing” corporate law for Russia, designed specifically to minimize resort to legal authority.¹ John Coffee has recently emphasized the role of cross-listings on foreign stock exchanges as a mechanism by which firms in weak enforcement regimes can bond themselves to “good” corporate law—by listing on a foreign stock exchange that imposes high disclosure requirements and subjects listed firms to a stringent foreign regulatory and private enforcement regime.²

But there is another partial solution to the problem of weak investor protection and corporate law enforcement, one that has received no theoretical or empirical attention—the nonprofit organization (NPO).³ This partial solution emerges from a puzzle at the center of contemporary East Asian corporate governance: nonprofit organizations have emerged as arguably the most important corporate law enforcement agents in Korea, Taiwan, and Japan. In Korea, the shareholders’ rights committee of a large, diversified NPO known as People’s Solidarity for Participatory Democracy (PSPD) “has brought the only significant shareholder actions to date,”⁴ winning two major court victories, including one against the chairman and managers of a leading *chaebol* (a conglomerate dominated by a controlling minority shareholder). In Taiwan, a nonprofit foundation known as the Securities and Futures Institute (SFI), established with the support of the government and the financial sector, has organized and filed *de facto* class action suits in securities and corporate fraud cases on behalf of thousands of small investors. In Japan, a group of activist lawyers and academics calling themselves the Shareholder [*Kabunushi*] Ombudsman “dominates the market [for derivative actions], has

1. See Bernard Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 HARV. L. REV. 1911, 1912 (1996) (noting that “[t]he self-enforcing model structures corporate decisionmaking processes to allow large outside shareholders to protect themselves from insider opportunism with minimal resort to legal authority” through such measures as mandatory cumulative voting and shareholder and board-level approval of self-interested transactions.)

2. See John C. Coffee, Jr., *Racing Towards the Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance*, 102 COLUM. L. REV. 1757 (2002).

3. A common definition of an NPO is an organization (formal or informal) that is private, self-governing, not profit-distributing, and voluntary. INST. FOR POLICY STUDIES, CTR. FOR CIVIL SOC’Y STUDIES, GLOBAL CIVIL SOCIETY AT-A-GLANCE: MAJOR FINDINGS OF THE JOHNS HOPKINS COMPARATIVE NONPROFIT SECTOR PROJECT, <http://www.jhu.edu/~cnp/pdf/glance.pdf>.

4. Kon Sik Kim & Joongi Kim, *Revamping Fiduciary Duties in Korea: Does Law Matter in Corporate Governance?* [hereinafter Kim & Kim, *Revamping Fiduciary Duties*], in GLOBAL MARKETS, DOMESTIC INSTITUTIONS: CORPORATE LAW AND GOVERNANCE IN A NEW ERA OF CROSS-BORDER DEALS 373, 389 (Curtis J. Milhaupt ed., 2003) [hereinafter GLOBAL MARKETS].

no recognizable equal, and has litigated several of the more high profile cases in Japan.”⁵

This brand of shareholder activism is puzzling on several levels. First, the defining characteristic of an NPO is the non-distribution constraint.⁶ That is, while NPOs are not prohibited from making profits, they are prohibited from distributing profits to their members or others who control them. Why are three organizations operating within the non-distribution constraint—rather than institutional investors or individual shareholders represented by plaintiffs’ attorneys—the principal shareholder activists *cum* corporate law enforcement agents in the three largest market economies of East Asia? Second, civil society is a comparatively recent development in this region, where states have traditionally not created much space for the formation of organizations pursuing independent objectives.⁷ Why is not the phenomenon of corporate law enforcement by NPO shareholder activists witnessed more extensively elsewhere, including in countries that have active nonprofit sectors?⁸

A partial solution to the puzzle of corporate law enforcement in East Asia, and the contours of a possible role for nonprofits in improving investor protection in some other economies, come into focus when we turn from facts to theory. For considerably longer than corporate law scholars have debated the causes of cross-country diversity in corporate structures, social scientists have sought to explain the existence of NPOs, and the vast disparity in the size of the NPO sector in individual countries around the world. While no single theory garners universal support, several influential, related theories help explain the recent phenomenon of NPO shareholder activism in East Asia.

5. Mark D. West, *Why Shareholders Sue: The Evidence from Japan*, 30 J. LEGAL STUD. 351, 369 (2001).

6. See Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 838 (1980).

7. See, e.g., Richard Estes, *Charitable Foundations in East Asia: Tax Shelters for the Well Off or Partners in Development?*, 22 SOC. DEV. ISSUES 3-14 (2000).

8. Of course, NPOs involved in corporate governance and corporate social responsibility are now prevalent throughout the world. In the United States, organizations such as the Corporate Library, the Shareholder Action Network, and the Investor Responsibility Research Center (IRRC) seek to promote good corporate governance. But these organizations differ in significant respects from the NPOs discussed in this Article. The U.S. NPOs principally serve as information clearinghouses or, as in the case of IRRC, promote the interests of their large institutional members. They are not civil society organizations as that term is commonly understood. Also, from an operational standpoint, NPOs in the United States do not organize plaintiffs in shareholder litigation, though nothing in U.S. tax law appears to prohibit nonprofits from playing a more direct role in corporate law enforcement by, for example, holding portfolios of stock so as to exercise shareholders rights. Perhaps the closest analogue outside of East Asia is Russia’s Institute of Corporate Law and Corporate Governance, founded by a former Chairman of the Federal Commission for the Securities Market of the Russian Federation. This organization’s objective is to protect investor rights by improving corporate governance in Russia. Its principal method for doing so is creating corporate governance ratings for Russian firms to allow investors to make informed investment and voting decisions. But it also offers legal consulting services, assistance with annual shareholders meetings, and due diligence services. (More information on the Institute of Corporate Law and Corporate Governance can be found on its website, at <http://www.iclg.ru/enservices#lk> (last visited Dec. 15, 2003)). The NPOs in East Asia are unique in that they not only focus their efforts on corporate law and corporate governance *per se* (as opposed to broader social issues), but also take direct action in organizing plaintiffs, holding portfolios of stock in their own right, and actively exercising rights as shareholders themselves (as opposed to the more passive role of providing information about corporate governance to investors).

By extension, understanding the East Asian experience may suggest ways to improve investor protection elsewhere.

One theory views NPOs as a response to unsatisfied demand for public goods—demand that grows as societies become more diverse, opening gaps in supply caused by government and market failures.⁹ In order to understand how this theory fits the East Asian experience, note that investor protection in the form of corporate and securities law enforcement is a public good: many of the benefits of the enforcement effort accrue to persons who are not required to bear their share of the enforcement costs. Note as well that demand for investor protection and “good” corporate governance has grown rapidly in the region as a result of the Asian financial crisis, domestic corporate scandals, and persistent economic malaise in Japan. Under these circumstances, if the infrastructure for private law enforcement is inadequate and the government is unable or unwilling to meet the increased demand for investor protection, the “government failure/market failure” theory predicts the emergence of NPOs to supply investor protection, at least where legal and social conditions for the development of an NPO sector are favorable.

A related “contract failure” theory views the NPO form as a device to economize on the costs of producing public goods, particularly where consumers are unable to evaluate the quality of the goods provided.¹⁰ This theory rests on the premise that the non-distribution constraint inherent in the NPO form makes it a “trustworthy” supplier where such information asymmetries are present, because the owners of such organizations have fewer incentives to take advantage of consumers than the owners of a for-profit firm. As this Article will show, this theory, applied to the government, helps explain why the Taiwanese securities regulatory agency supports an investor protection NPO, and suggests that government–NPO partnerships have the potential to supplement weak state enforcement of corporate and securities laws.

A third theory focuses on the supply side, noting that the demand for public good production can only be met by NPOs if there is an adequate stock of individuals (what might be called “social entrepreneurs”) to found and operate these organizations.¹¹ This theory recognizes that certain social environments are more conducive than others to the supply of social entrepreneurs. The literature has focused on the role of religious competition in expanding supply, but this is hardly the only environment conducive to social entrepreneurship. For example, a comparatively larger stock of social entrepreneurs would likely exist in societies with a history of organized protest against the government—a circumstance relevant to the East Asian experience.

9. BURTON A. WEISBROD, *THE NONPROFIT ECONOMY* 25-27 (1988).

10. Hansmann, *supra* note 6, at 848-854.

11. See, e.g., Estelle James, *Introduction to THE NONPROFIT SECTOR IN INTERNATIONAL PERSPECTIVE* 3, 6 (Estelle James ed., 1989).

While these theories fall short of a fully formed account of NPOs in corporate law enforcement around the world,¹² they do help explain why NPO shareholder activists have emerged to fill a shortfall in the supply of investor protection-related public goods in the increasingly diverse socio-economic structures of Japan, Korea, and Taiwan. This form of law enforcement appears to be most successful in Korea, where the supply and quality of social entrepreneurs is highest due to its recent history of organized protest against authoritarian governments, and where government policy and the legal environment are conducive to an active NPO sector. The Taiwanese example is also noteworthy, because the government has consciously co-opted an NPO into its public good supply chain. The Japanese NPO, comparatively less prominent than its other East Asian counterparts, reflects both a somewhat more robust corporate law enforcement environment (hence fewer gaps in the supply of public goods), a smaller stock of experienced activists, and a political and legal environment that has traditionally channeled organized nongovernmental activism into highly localized causes.

NPO shareholder activism in East Asia, which has been the focus of virtually no theoretical or comparative analysis,¹³ has significant implications for ongoing academic debates in comparative corporate governance as well as real-world reform efforts. Academically, two points are well recognized in comparative corporate governance theory, but not thoroughly explored empirically. First, the quality of law enforcement is at least as important to “good” investor protection as high-quality statutory law.¹⁴ Second, convergence of legal systems at the formal level may not eliminate differences in practice. Conversely, functional equivalents may lead to convergent outcomes even where significant differences remain among corporate governance systems at the formal level.¹⁵

The emergence of NPOs as the leading non-state corporate law enforcement agents in East Asia is a novel and important illustration of both points. Despite recent, extensive corporate governance reform in all three countries at the statutory level, the enforcement environment remains problematic. While by no means perfect, the NPOs analyzed here are important—perhaps even the only—aggressive enforcement agents in the

12. Jeff Gordon suggested that a valuable extension of this Article would be to develop a more complete theory of public goods production in corporate governance, focusing on share ownership patterns and the viability of courts. My goals for this Article, however, are more modest.

13. The activities of the three NPO shareholder activists have been separately described in several excellent English-language publications cited extensively in Part IV. See Jooyoung Kim and Joongi Kim, *Shareholder Activism in Korea: A Review of How PSPD Has Used Legal Measures to Strengthen Korean Corporate Governance*, 1 J. KOREAN L. 51 (2001) [hereinafter Kim & Kim, *PSPD*] (describing the Korean NPO); Lawrence S. Liu, *Simulating Securities Class Actions: The Case of Taiwan*, 3 CORP. GOVERNANCE INT'L 4, 8 (2000) [hereinafter Liu, *Simulating Securities Class Actions*] (describing the Taiwanese NPO); West, *supra* note 5 (describing the Japanese NPO). But no attempt has been made to explain the emergence of these organizations theoretically or in comparative perspective, or to examine the academic and practical implications of their activities beyond the confines of the separate systems in which they operate.

14. See, e.g., Luca Enriques, *Off the Books, but on the Record: Evidence from Italy on the Relevance of Judges to the Quality of Corporate Law*, in GLOBAL MARKETS, *supra* note 4, at 257.

15. Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMP. L. 329, 331 (2001).

corporate governance environments of the three countries in which they are active. All three organizations have found ways to improve the quality of investor protection in their home countries, despite—or perhaps more accurately, because of—shortcomings in public and private enforcement mechanisms.

Moreover, the NPO as a supplier of investor protection is a highly distinctive illustration of functional convergence—that is, the use of strikingly different institutional forms to accomplish a common objective, such as corporate law enforcement.¹⁶ In East Asia, several markedly different societies have spontaneously generated an NPO substitute for the attorney-oriented incentive mechanisms relied upon in the United States to provide law enforcement-related public goods in the field of corporate governance. Neither the NPO nor the “private attorney general” ensures an optimal supply of investor protection, but these two enforcement alternatives are distinct paths toward the same goal.

Yet the experience of East Asia with NPOs as corporate law enforcers is not an unalloyed convergence story. Even in their common use of the non-distribution constraint to advance the objective of investor protection, Japan, Korea, and Taiwan display striking diversity in the organizational forms, strategies, and successes of their NPOs. This diversity can be traced to the distinctive legal, political, and social environments in which NPOs have emerged and exist in the three systems.

At the level of law reform, the lessons from East Asia for other transition economies may be significant, particularly where there is hesitation or inability to replicate the U.S. “private attorney general” model of corporate law enforcement. While the use of the NPO form as a law enforcement device has its own serious limitations,¹⁷ this innovation is worthy of serious study as a way to improve the corporate governance environments in China, Russia, and other transition countries. NPOs may be less effective than other functional substitutes for domestic enforcement, such as firms bonding themselves to “good” corporate law through cross-listings on foreign exchanges. Shareholder activist NPOs are inherently domestic organizations, however, and that attribute holds out the promise of improving local law enforcement institutions. The other alternatives discussed in the literature (save for massive long-term investments in legal infrastructure) generally involve abandoning local legal regimes.

The Article is organized into six parts. Part II presents the puzzling yet significant role of nonprofit organizations in the corporate governance environments of Korea, Taiwan, and Japan. Part III outlines several complementary theories from social science literature explaining the existence of NPOs—theories that shed light on the puzzling form corporate law enforcement has taken in East Asia. Part IV applies these theories in two ways—first, to explain the emergence of NPO shareholder activism in Japan, Korea, and Taiwan, and second, to explain why substantial diversity exists in

16. On the distinction between formal and functional convergence, see *id.*

17. These limitations are explored *infra* Part V.

the structure and operations of these NPOs despite their common role as corporate law enforcement agents. Part V draws implications from this distinctive East Asian experience for comparative corporate governance literature and for corporate law enforcement in transitional economies. Part VI is a brief conclusion.

II. PUZZLE: THE ROLE OF NPOs IN EAST ASIAN CORPORATE GOVERNANCE

As noted in the Introduction, a puzzling feature of contemporary East Asian corporate governance is the presence of an organization operating within the non-distribution constraint as a major corporate law enforcement agent in each of the three largest market economies in the region. This Part introduces the puzzle by describing the three shareholder-activist/investor-protection NPOs operating in Korea, Japan, and Taiwan.

A. Korea

The People's Solidarity for Participatory Democracy (PSPD) was founded in 1994. Legally, it is a nonprofit organization registered with the Seoul Metropolitan government. Its membership has grown rapidly, from 200 at its founding to over 12,000 currently, so that today, eighty percent of its monthly budget is funded out of membership fees.¹⁸ It has a professional staff of fifty, but its activities rely heavily on the voluntary participation of lawyers and other experts. PSPD is actually a nonprofit "holding company" for several "action bodies" engaged in a wide variety of advocacy efforts, including judicial oversight and a taxpayer's movement. One of these action bodies is the Participatory Economic Committee (PEC), which launched a Small Shareholders Rights Campaign in 1997. The campaign's aim is to protect minority shareholder rights and improve corporate management by mobilizing small shareholders to act collectively against the *chaebol*, i.e., conglomerates dominated by a controlling minority shareholder, typically the founder or his family.¹⁹ The complexity of intra-*chaebol* firm relationships, the history of close, if at times contentious, relations with the government, and, above all, the use of pyramidal and circular shareholding structures by founding families to maintain control over group firms despite relatively low cash flow rights, has given rise to some acute corporate governance problems in Korea.²⁰ Through the activities of the PEC targeting these problems, PSPD has become

18. Unless otherwise noted, factual information in this Section is taken from the PSPD website, at <http://www.pspd.org> (last visited Dec. 13, 2003).

19. Hyuk-Rae Kim, *NGOs in Pursuit of 'the Public Good' in Korea*, in COLLECTIVE GOODS, COLLECTIVE FUTURES IN ASIA 58, 66 (Sally Sargeson ed., 2002).

20. See, e.g., Ok-Rial Song, *The Legacy of Controlling Minority Structure: A Kaleidoscope of Corporate Governance Reform in Korean Chaebol*, 34 LAW & POL'Y INT'L BUS. 183 (2002). For a recent illustration, see Don Kirk, *Purchase of Shares Reignites Governance Debate in Korea*, N.Y. TIMES, July 24, 2003, at W1 (reporting that intra-group purchase of a large block of shares from a troubled *chaebol* firm is "viewed as reflecting the cronyism in Korea's conglomerates").

the leading shareholder activist,²¹ and indeed, “the most influential citizen . . . movement in Korea.”²²

PSPD consciously targeted leading companies for its initial activism efforts, seeking to make them good role models for other firms.²³ While it engages in a variety of non-legal activities to promote corporate governance, PSPD has utilized the legal system as one of its principal tools of reform.²⁴ Toward this end, it holds a portfolio of stock so that it has standing to exercise shareholders’ rights. By participating in shareholder meetings, PSPD has obtained the disclosure of information and managerial acceptance of corporate governance reform at a number of major *chaebol* firms, including SK Telecom, Hyundai Heavy Industries, and Daewoo Corporation.²⁵ It likewise successfully sued to nullify resolutions passed at a shareholders meeting where irregularities occurred. PSPD has also launched several proxy solicitations aimed at attracting foreign institutional investors to its cause, sought injunctions against illegal managerial conduct, and filed administrative complaints against lawyers and accountants for aiding such conduct.²⁶ In addition, it successfully proposed a series of reforms to the Commercial Code and Securities Exchange Act. Most recently, PSPD was instrumental in initiating an investigation of fraud and insider trading at the SK Group, Korea’s third largest *chaebol*. The investigation resulted in the prosecution and conviction of ten senior executives within the group.

Most importantly, PSPD has achieved two major victories in shareholder derivative suits.²⁷ The first—indeed the first shareholder derivative suit in Korean history—was a suit against the former directors of Korea First Bank, filed on behalf of sixty-one minority shareholders. The claim alleged that directors had accepted bribes in return for the extension of credit to a failing conglomerate, while instructing staff to proceed with the loans despite knowledge of the borrower’s poor financial condition. A 40 billion won (\$44 million) decision was rendered against the directors in 1998.²⁸ As a result, directors were aware, for the first time, of their fiduciary obligations to their shareholders. Then, in 2001, PSPD won a judgment in a shareholder derivative suit brought on behalf of twenty-two shareholders against the controlling shareholder and nine directors of Samsung Electronics. In the case, which bears a resemblance to the important American case *Smith v. Van Gorkom*,²⁹ the court held the directors liable for failing to exercise business judgment in the acquisition of a failing target company. As in *Van Gorkom*,

21. For a detailed discussion of PSPD’s corporate governance activities, see Kim & Kim, *PSPD*, *supra* note 13.

22. Ki-Young Sung, *Bargaining Small Shareholders’ Rights*, 492 SISA 74 (1999) (quoted in Kim, *supra* note 19, at 68).

23. Kim & Kim, *PSPD*, *supra* note 13, at 53.

24. *Id.* at 54.

25. Kim, *supra* note 19, at 67.

26. *See generally* Kim & Kim, *PSPD*, *supra* note 13.

27. A derivative suit is brought by a shareholder to enforce a corporate cause of action. The action seeks recovery, on behalf of the corporation, for damages caused by a director’s breach of duty. If successful, any award (minus attorneys’ fees) returns to the corporation.

28. Kim & Kim, *PSPD*, *supra* note 13, at 68.

29. *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985).

the court found the directors' conduct to lie beyond the protective confines of the business judgment rule where negotiations proceeded with undue haste and inadequate diligence by the board. In addition, the chairman of Samsung Electronics was found liable for making an illegal political contribution, and six directors were held liable for approving a related-party transaction on unfair terms. According to Korean corporate law experts, the Samsung Electronics case sent an even more powerful message to the business community than the Korea First Bank case, indicating that even managers of Korea's most profitable and well-known firms are legally accountable to their shareholders.³⁰ Reinforcing the public goods quality of PSPD's activities in these cases, the NPO itself was not paid any damages since these were shareholder derivative suits, and the PSPD attorneys who handled the litigation provided their services without compensation.

B. *Taiwan*

The Securities and Futures Institute (SFI) is an ingenious mechanism for overcoming collective action problems in shareholder litigation. The SFI holds 1,000 shares (one trading unit) in each public company in Taiwan, giving it standing to assert claims as a shareholder.³¹ It also functions as a public interest law firm on investor protection issues. The SFI has procedures in place to take on claims of private investors in securities cases. In cases where a public prosecution has been initiated, the SFI will either assert its own claim or bring a "de facto class action" as an agent for other investors.

SFI is not a typical NPO. It was founded as a nonprofit foundation in 1984 through the cooperation of Taiwan's securities regulatory agency and the local banking and securities industries.³² The foundation was initially funded from 1984 to 1987 through a special assessment on securities trading commissions levied against brokerage firms and banks.³³ In contrast to most NPOs, the SFI has a large, highly professional, and experienced staff.³⁴ And according to its own publication, "[t]he SFI has supported government national economic development policy since its founding."³⁵ Thus, in many respects, SFI is a quasi-public organization. Yet, as explored in more detail in

30. Kim & Kim, *Revamping Fiduciary Duties*, *supra* note 4, at 392. In November 2003, a Korean appellate court affirmed the District Court's finding of liability for illegal political contributions and related party transactions, but reversed the District Court's finding of liability for the acquisition of the failing company. According to Korean experts, the case will almost certainly proceed to the Supreme Court of Korea.

31. Lawrence S. Liu, *A Perspective on Corporate Governance in Taiwan*, 31 ASIA BUS. L. REV. 29, 35 (2001) [hereinafter Liu, *Corporate Governance in Taiwan*].

32. It was founded as the Securities and Futures Market Development Institute. The name was changed in 1992. The discussion in the text is drawn from Liu, *Simulating Securities Class Actions*, *supra* note 13.

33. SECURITIES AND FUTURES INSTITUTE, 2002 ANNUAL REPORT 9 (2003) [hereinafter SFI ANNUAL REPORT].

34. *Id.* at 15 (noting that the professional staff of eighty-nine includes one Ph.D. holder and twenty-five M.A. degree holders, and that twenty percent of the staff has served for more than ten years).

35. *Id.* at 10.

Section IV.C, it is significant that the government chose the NPO form to extend its reach in the field of investor protection.³⁶

The SFI engages in both non-enforcement and enforcement activities. Non-enforcement related activities include conducting research, taking investor complaints, helping to settle disputes, providing legal consultation, and promoting investor education.³⁷ As a shareholder, SFI also participates in shareholders meetings, particularly where a company is in financial crisis or is issuing substantial amounts of new equity.³⁸ Enforcement actions fall into several categories: executing disgorgement rights for short-swing trading profits (on grounds similar to those in Section 16 of the U.S. Securities Exchange Act of 1934)³⁹ and acting as agent in shareholder suits and de facto class actions. Court costs and attorneys' fees are funded by the SFI, and in turn by the SFI's funding sources. Thus, SFI's contributors "are willing to subsidize the cost [of] civil enforcement."⁴⁰

Statistics indicate that the SFI has been active in its law enforcement role. As of 2002, the SFI has filed class actions against twenty-four companies on behalf of 9,700 investors, seeking NT\$4.7 billion (about \$150 million) in civil damages.⁴¹ Since 1998, SFI has filed more than 2,000 disgorgement actions for short-swing profits, seeking NT\$8.7 billion (about \$300 million). It played a leading enforcement role in a series of major corporate scandals that emerged in Taiwan in the late 1990s. Typically acting on behalf of hundreds of investors, SFI sued numerous so-called "landmine companies," whose controlling shareholders had used affiliates to manipulate stock prices and siphon off corporate assets.⁴² These cases are still pending.

C. Japan

Shareholder Ombudsman, an NPO "dedicated to the goal of reforming Japanese management practices to incorporate the views of ordinary shareholders and citizens,"⁴³ was founded in 1996 by a group of lawyers,

36. Some commentators on previous drafts of this Article have expressed doubt that SFI should be considered an NPO at all, given its close relationship to the government. But the SFI meets both the legal and functional definition of an NPO—it is a registered nonprofit foundation under Taiwanese law, and its members are bound by the non-distribution constraint. Moreover, close connections between the NPO sector and the government are hardly unique to Taiwan. More importantly from my perspective, the fact that a governmental agency utilizes a separate, "quasi-private" organization to accomplish certain regulatory goals suggests that something distinctive about the NPO form is missed when it is analytically lumped together with "the government." The question of why a governmental agency would co-opt an NPO into its public goods supply chain is explored in Section IV.C.

37. SFI ANNUAL REPORT, *supra* note 33, at 17-37.

38. *Id.* at 33.

39. Unlike U.S. securities law, however, under the Taiwanese securities law, the *corporation* must force disgorgement of such profits, and shareholders may sue if the corporation fails to do so.

40. Liu, *Corporate Governance in Taiwan*, *supra* note 31, at 36.

41. See SFI ANNUAL REPORT, *supra* note 33.

42. Liu, *Simulating Securities Class Actions*, *supra* note 13, at 8-12.

43. Kabunushi (Shareholders) Ombudsman, *About Kabunushi (Shareholders) Ombudsman—Its Goals and Activities*, at <http://www1.neweb.ne.jp/wa/kabuombu/english-02.htm> (last visited Dec. 13, 2003).

accountants, and academics.⁴⁴ The organization is a spin-off of the Osaka-based Citizens' Ombudsman, a watch dog group that monitors the government bureaucracy and the relationship between government and business. At its founding, Shareholder Ombudsman had 150 members and a portfolio of 300 stocks. Its members were divided into three groups—shareholder members, specialist members, and citizen members—but the core group of active participants only numbered about fifteen.⁴⁵ Given the legal nature of its work, specialist members in the form of elite attorneys are the core of the organization.

Although not legally established as a nonprofit organization under Japan's Civil Code due to the onerous formation requirements in effect at the time of its founding, Shareholder Ombudsman is organized and functions as if its members were bound by the nondistribution constraint.⁴⁶ As one observer has noted, while Shareholder Ombudsman has the legal form of a limited liability company [*yūgen gaisha*], the objectives stated in its charter—exercising shareholders' legal rights, improving corporate information disclosure, and serving as a voice for the expression of shareholder opinion—are public goods.⁴⁷ Since Shareholder Ombudsman's principal weapon is the derivative suit—an action in which compensation won by plaintiffs returns to the corporation—the only direct economic returns available to members of the NPO are attorneys' fees. But senior Shareholder Ombudsman attorneys typically donate any fees to which they are entitled to the organization. Indeed, most of the organization's operating expenses are funded by such donations.⁴⁸ While junior attorneys working on successful cases do receive modest compensation out of the attorneys' fees paid by the defendant corporation,⁴⁹ this does not set Shareholder Ombudsman apart from NPOs that pay modest salaries to their staff members.

As noted in the Introduction, Shareholder Ombudsman has been involved in many of the high-profile shareholder derivative suits in Japan.

44. Hiroshi Otsuka, *Iraishanaki Hōdōin: "Kabunushi Onbuzuman" to kabunushi daihyō soshō* [Client-less Legal Activists: "Shareholder Ombudsman" and Shareholder Derivative Suits], 47 KŌBE HŌGAKU ZASSHI [KŌBE L. REV.] 705, 733 (1997); *About Kabunushi (Shareholders) Ombudsman—Its Goals and Activities*, *supra* note 44.

45. Otsuka, *supra* note 44, at 734.

46. *Id.* at 736. According to lawyers involved with the organization, the nonprofit form was not selected due to the high initial endowment requirements under the Civil Code. The Civil Code provides for two types of nonprofit organizations: the incorporated foundation [*zaidan hōjin*] and the incorporated association [*shadan hōjin*]. The required minimum endowment to establish an incorporated association is ¥100 million (about \$800,000). Moreover, nonprofits are granted legal status under the Civil Code only at the discretion of government ministries with jurisdiction over their activities. Even if legal status as a nonprofit is obtained, tax deductibility for contributions to such organizations is granted only at the discretion of the Ministry of Finance. Less than three percent of the 9,000 nonprofit organizations formed under the Civil Code have been granted tax-favored status. Yoshinori Yamaoka, *Untitled Draft*, at 6 (unpublished manuscript, on file with The Yale Journal of International Law) (2002). In 1998, a new NPO law was enacted, providing for registration as of right to organizations that meet specified statutory requirements. Law to Promote Specified Nonprofit Activities, Law No. 7 of 1998, arts. 1, 2 (1998), http://www.jcie.or.jp/civilnet/civil_soc_monitor/npo_law.html. The Shareholder Ombudsman has applied for NPO status under this law.

47. Otsuka, *supra* note 44, at 737.

48. E-mail from Yoshihiro Yamada, an academic affiliated with Shareholder Ombudsman, to author (Nov. 19, 2002) (on file with The Yale Journal of International Law).

49. West, *supra* note 5, at 369.

From 1996 to 2001, according to information published by the organization, Shareholder Ombudsman filed twelve derivative suits, including cases against the directors of some of Japan's best known companies, such as Sumitomo Corporation, Nomura Securities, Takashimaya Department Store, Daiichi-Kangyo Bank, Ajinomoto, Yamaichi Securities, Japan Airlines, Kobe Steel, and Mitsubishi Motors.⁵⁰

Although Shareholder Ombudsman has not obtained a favorable judgment in any of its cases, it has settled at least half-a-dozen suits. These include a ¥430 million (\$4 million) settlement with the directors of Sumitomo Corporation for unauthorized copper trading losses, a ¥310 million (\$3 million) settlement with the directors of Kobe Steel for payoffs to racketeers, and a settlement with the directors of Japan Airlines for failure to comply with a law mandating that a certain percentage of its workforce be comprised of disabled workers. Many of these settlements involve not only cash reimbursements by the directors to their respective corporations, but also commitments from the firm to establish mechanisms to prevent the conduct from recurring. For example, the Kobe Steel settlement included a commitment by the corporation to establish a compliance committee to prevent future malfeasance. The Japan Airlines settlement included a commitment to increase the employment of disabled workers over time until the statutory requirement was met, together with the payment of a ¥40-50 million (\$400,000-\$500,000) fine to the government annually for an extended period of time. Thus, some of these settlements are arguably the equivalent of a judicial victory both in terms of compensation received—indeed, the settlement in the Takashimaya case slightly exceeded the amount of damages sought in the litigation—and their impact on the corporate community. The proximity of a Shareholder Ombudsman's settlement to a victorious judgment is particularly close in cases such as the Kobe Steel suit, in which the district court publicly released a settlement memorandum outlining its finding of clear violations of the duty of care and loyalty by the directors.⁵¹

Apart from derivative litigation, Shareholder Ombudsman has engaged, to a limited extent, in other activist efforts. It has directly, or through shareholders affiliated with the group, filed shareholder proposals against several prominent firms such as Sony and Sumitomo Bank. For example, the Sony proposal sought disclosure of directors' individual salaries and retirement bonuses.⁵² While none of the proposals has garnered sufficient votes to be adopted, management has responded to some of the organization's recommendations.⁵³ Recently, for example, Shareholder Ombudsman withdrew a shareholder proposal against a scandal-plagued food products company after the corporation agreed to appoint an outside director nominated by a national

50. See *About Kabunushi (Shareholders) Ombudsman—Its Goals and Activities*, *supra* note 43.

51. *Soshō no shoki shuketsu ni mukete no saibansho no shoken* [The Court's Findings on Early Termination of the Litigation], at <http://www1.neweb.ne.jp/wa/kabuombu/koube01.htm> (last visited Dec. 13, 2003).

52. *The First Year of the Shareholder's Proposals Era*, at <http://www1.neweb.ne.jp/wa/kabuombu/020703-01.htm> (last visited Dec. 15, 2003).

53. *About Kabunushi (Shareholders) Ombudsman—Its Goals and Activities*, *supra* note 43.

consumer group.⁵⁴ Shareholder Ombudsman has also made two forays into the legislative reform process. It unsuccessfully opposed pro-management amendments to the Commercial Code's derivative suit procedures. More recently, it has supported passage of a whistle blower statute, which is opposed by business groups and to date has not been enacted. Finally, Shareholder Ombudsman has carried out campaigns to improve the shareholder meeting process.

III. THEORY: NPOS, PUBLIC GOODS, TRUST, AND SOCIAL ENTREPRENEURSHIP

Although the nonprofit sector has been described as the “lost continent” on the social landscape of modern society[,]”⁵⁵ a burgeoning literature explores questions that closely parallel those now preoccupying scholars of comparative corporate governance. These questions include how to account for significant cross-country diversity in NPO size and role, and the impact of domestic legal environments on the establishment and performance of NPOs.⁵⁶

Paralleling the theory of the firm debate in corporate literature, much theoretical attention has been devoted to the fundamental question of why NPOs exist. While no single theory garners universal support, one highly persuasive theory, most closely associated with Burton Weisbrod, views NPOs as a response to government and market failures in the supply of public goods.⁵⁷ In classical economics, market failure is of course the major justification for government. But Weisbrod noted that in a democracy, “government failure” is also common, since decisions about which public goods to produce and in what quantity will most often reflect the preferences of the median voter. The more heterogeneous the population, therefore, the larger the unsatisfied demand for public goods. In Weisbrod's framework, NPOs emerge to supply public goods that are not provided by the state or the market.

The “government failure/market failure” theory generates a straightforward hypothesis: the size of the NPO sector should vary with the

54. See *The First Year of the Shareholder's Proposals Era*, *supra* note 52.

55. LESTER M. SALAMON ET AL., SOCIAL ORIGINS OF CIVIL SOCIETY: AN OVERVIEW I (Johns Hopkins Comparative Nonprofit Sector Project, Working Paper No. 38, 2000).

56. This literature predates the comparative corporate governance debate by a decade. See, e.g., Estelle James, *The Nonprofit Sector in Comparative Perspective*, in *THE NONPROFIT SECTOR: A RESEARCH HANDBOOK* 397, 402-05 (Walter W. Powell ed., 1987).

57. BURTON WEISBROD, *THE VOLUNTARY NONPROFIT SECTOR* (1977); Burton Weisbrod, *Toward a Theory of the Voluntary Non-Profit Sector in a Three-Sector Economy*, in *ALTRUISM, MORALITY, AND ECONOMIC THEORY* 171 (Edmund S. Phelps ed., 1975). See also Kim, *supra* note 19, at 62 (“There is, therefore, a functional logic to the emergence of NPOs as providers of goods that are under-supplied by both the market and the government.”) (citations omitted). Knowledgeable commentators have called the “government failure/market failure” concept “the dominant theoretical perspective in the nonprofit field until relatively recently.” Lester Salamon & Helmut K. Anheier, *Social Origins of Civil Society: Explaining the Nonprofit Sector Cross-Nationally*, 9 *VOLUNTAS* 213, 220 (1998). While this theory is still highly influential, other persuasive theories, including the “contract failure” and “social entrepreneur” concepts, are also viewed today as important advances in the scholarly understanding of the field. See *infra* notes 59-62 and accompanying text.

degree of heterogeneity in a given society. While by no means unchallenged in its dominance, this theory in fact finds considerable empirical support in cross-country studies of the non-profit sector.⁵⁸

An important extension of this theoretical linkage between NPOs and public goods is the notion of “contract failure” developed by Henry Hansmann.⁵⁹ Hansmann noted that people are in fact willing to produce public goods in many circumstances. However, difficulties inherent in measuring the quality of public goods create severe information problems for consumers. In theory, these information problems could be overcome with a sufficiently detailed contract, but the costs of such contracting are prohibitive. The NPO—essentially a state-supplied standard form contract imposing the non-distribution constraint on an organization’s members—economizes on the costs of writing and enforcing a contract to ensure that consumers’ expenditures bear a relationship to the goods supplied. Put differently, the non-distribution constraint inherent in the NPO form makes it a more trustworthy producer of public goods than for-profit firms.⁶⁰

Influential as the foregoing theories may be, responses to the demand for public goods are not likely the sole explanation for the emergence of NPOs. A corollary theory focuses on the individuals who supply public goods. The supply-side theory recognizes that the demand for public goods can be met by NPOs only if there is a supply of people—“social entrepreneurs”—with the qualifications and incentives to establish NPOs. As commentators note, however, “the appearance of such individuals is not random It is most likely under particular circumstances.”⁶¹ While religious competition is typically viewed in the literature as the factor most conducive to the emergence of social entrepreneurs (because the provision of social services is a way to attract new adherents to a religion),⁶² intuitively it should not be the only such factor. Although it seems not to have received rigorous attention in the literature, another environment that is likely to spawn social entrepreneurs is the young democracy, particularly one that has recently emerged out of an authoritarian regime that generated organized popular protests. Such a society should be more likely to have a stock of trained and motivated social entrepreneurs who received their “training” in movements against the prior regime. As explained below, these circumstances appear to be part of the alchemy supporting the corporate governance NPOs in Korea and Taiwan.

In addition to this theoretical work, there are close parallels in the NPO scholarship to the influential “law and finance” work, which links the size of capital markets and the dispersion of shareholding around the world to the

58. See, e.g., Salamon & Anheier, *supra* note 57, at 232-237. In the literature, heterogeneity is measured by ethno-linguistic fractionalization. In theory, however, other forms of heterogeneity should be equally important.

59. See Hansmann, *supra* note 6, at 845.

60. *Id.* at 848-854.

61. Salamon & Anheier, *supra* note 57, at 221.

62. See, e.g., James, *supra* note 11, at 6; Salamon & Anheier, *supra* note 57, at 237-38.

quality of domestic legal environments.⁶³ Just as law appears to influence the size and financing structure of firms in the for-profit economy, so too, the legal environment seems to influence the size and role of the nonprofit sector around the world.⁶⁴ At the most basic level, legal regimes can make it easy or difficult to form an NPO, subject NPOs to little or intrusive governmental oversight, and subsidize or not subsidize NPO activities through the favorable tax treatment of donations. It also seems highly plausible that legal regimes may affect NPO activity in a variety of other, less direct ways. For example, speech and assembly laws may affect the supply of social entrepreneurs in society, and levels of governmental corruption may drive demand for alternative sources of public goods. To my knowledge, these less direct links between law and the NPO sector have not been systematically explored in the literature, though intuitively they appear highly plausible.

While the theories outlined above by no means explain the totality of the nonprofit sector of the economy,⁶⁵ they do suggest that corporate law enforcement, as a public good, could be fertile ground for NPO involvement. This might be particularly true in a region such as East Asia, where expectations about corporate governance, corporate performance, and the role of the state in economic management have become more heterogeneous due to rapid economic growth and political change; where demand for corporate law enforcement has increased with the decline of institutional structures (such as extensive corporate relationships with banks and governmental actors that at one time partially substituted for formal law enforcement); and where a stock of social entrepreneurs may have been created in Korea and Taiwan during the recent democratization process. This is not to suggest that NPOs will always emerge to remedy government and market failures in the supply of investor protection (or any other public good). Indeed, theory and experience suggest that an environment conducive to productive NPO activity is rather elusive and highly sensitive to local social and legal conditions.

IV. APPLICATION: NPOS AS INVESTOR PROTECTION

In this part of the Article, I show that the emergence of NPOs as suppliers of investor protection in Japan, Korea, and Taiwan is generally consistent with key insights of the theories discussed above, helping to unravel the puzzle of corporate law enforcement in East Asia and suggesting a potentially more active role for NPOs in the corporate governance environments of other countries. I wish to emphasize again the modesty of my theoretical ambitions: I am not asserting that the theory just sketched fully

63. Raphael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998) [hereinafter La Porta et al., *Law and Finance*]; Raphael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997) [hereinafter La Porta et al., *Legal Determinants*].

64. See, e.g., PHILANTHROPY AND LAW IN ASIA: A COMPARATIVE STUDY OF THE NONPROFIT LEGAL SYSTEMS IN TEN ASIA PACIFIC SOCIETIES (Thomas Silk ed., 1999).

65. For example, as Mel Eisenberg pointed out to me, existing theory seems impoverished in its emphasis on government and market "failures" as the motivating impulse for the creation of NPOs. The nonprofit sector represents a distinct form of activity, apart from governmental and market activity, with its own reason for being.

explains the pattern of NPO involvement in corporate law enforcement around the world. Rather, I am suggesting that it is possible to significantly leverage our understanding of the East Asian experience by drawing on theories developed to explain the general phenomenon of NPOs. The discussion begins by briefly examining the public goods attributes of corporate law enforcement, and moves to an evaluation of specific factors in these systems that may lead to gaps between supply and demand for this public good. It then shifts to an analysis of several common and divergent attributes of the NPOs in East Asia that have emerged to meet the unmet demand, and ties the differences to diversity in local legal, historical, and political environments. The final section evaluates—and ultimately discounts—an alternative cultural explanation for this phenomenon.

A. *Corporate Law Enforcement as a Public Good*

Since the dominant theory views NPOs as a response to gaps in the supply of public goods, the first step in our discussion is to highlight the public goods qualities of corporate law enforcement. Indeed, corporate law enforcement displays the classic attributes of a public good: indivisibility and non-excludability. A shareholder's "consumption" of investor protection and good corporate governance does not reduce the benefits available to others, and it is not possible for the law enforcer/activist to exclude others from most or all of the benefits conferred by his or her efforts. The shareholder derivative suit presents the problem in its most extreme form. The plaintiff bears the cost of the suit. But each of the firm's shareholders indirectly partakes of any monetary award and benefits from whatever specific deterrent effect the suit has on management.⁶⁶ The shareholding public benefits to the extent that the enforcement effort has a general deterrent effect on other corporate managers. To the extent that the law enforcement effort results in the creation of "better" law, the general public benefits from a more efficient environment for economic activity.⁶⁷

In many ways, the United States and East Asia stand at opposite ends of the spectrum in their approaches to the public goods problem of law enforcement. As John Coffee notes, "[p]robably to a unique degree, American law relies upon private litigants to enforce substantive provisions of law that in other legal systems are left largely to the discretion of public enforcement agencies."⁶⁸ This U.S. "private attorney general" model rests on procedural rules that establish fee arrangements for plaintiffs' attorneys. These mechanisms may lead to over-enforcement, particularly as they relate to

66. Note the somewhat different derivative suit dynamics in systems characterized by dominant shareholders, such as Korea. There, the victorious derivative suit can be viewed as a wealth transfer from the dominant shareholder (who may be functionally indistinguishable from the director-defendants) to minority shareholders.

67. 2 AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS 12 (1994).

68. John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 669 (1986).

corporate and securities law.⁶⁹ In any event, they stand in sharp contrast to the corporate law enforcement environment in East Asia, which contains relatively weak private incentives for law enforcement.

As a crude illustration of the difference in approach, consider the number of shareholder derivative suits filed in the United States versus the East Asian systems. Definitive data on the number of shareholder suits in the United States are unavailable, but all existing evidence indicates that large numbers of suits are filed in any given year. For example, one prominent study found that nineteen percent of a random sample of 535 publicly traded U.S. corporations experienced derivative litigation between the late 1960s and 1987.⁷⁰ By contrast, the derivative suit mechanism has never been invoked against the directors of a public company in Taiwan, although Taiwanese corporate law has contained a derivative suit mechanism since the mid-1960s. The same situation prevailed in Korea until 1997. Since then a handful of suits (about twelve) has been filed,⁷¹ but the number remains low, particularly considering the major corporate governance problems of Korean firms exposed by the Asian financial crisis.⁷² Japan averaged about one derivative suit every two years for the first forty years in which its derivative suit mechanism was in place, until a procedural change in 1993 lowered enforcement costs. Since that time, there has been a modest explosion of shareholder litigation, with more than 500 suits filed.⁷³

The incidence of derivative litigation is by no means a perfect measure of corporate law enforcement and the quality of investor protection in a given system. Indeed, for reasons explored in depth by Roberta Romano, many derivative suits have more to do with attorney incentives than investor protection.⁷⁴ Yet the incidence of derivative litigation in a given system is at least one objective measure of the extent to which shareholders' rights are exercised, and this measure seems to correlate with a broader range of available evidence on law enforcement in the various countries.⁷⁵ This comparison, though crude, lends support to the common perception that the United States and East Asia have adopted quite different approaches to the public goods problem inherent in corporate law enforcement. The Japanese

69. See, e.g., Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. ECON. & ORG. 55, 55-56 (1991).

70. *Id.* at 58-59.

71. This is a consensus estimate provided to the author by several Korean corporate law scholars.

72. It is not clear why the number of derivative suits in Korea has remained so small in comparison to Japan, particularly given that the two countries now have similar procedural environments for derivative litigation. See *infra* Section IV.B.1.

73. This figure is supported by unpublished data provided to the author by the Supreme Court of Japan. Two points about the Japanese data: first, they suggest that, to a greater extent than SFI or PSPD in their respective jurisdictions, Shareholder Ombudsman has some competition for its role in corporate law enforcement in Japan. Second, they suggest that transaction costs arising out of the institutional environment, rather than amorphous cultural factors, account for the disparities between the East Asian systems and the United States. Once the transaction costs of filing suit in Japan were reduced, resort to "U.S.-style" enforcement mechanisms increased markedly.

74. See, e.g., Romano, *supra* note 69; West, *supra* note 5.

75. See, e.g., West, *supra* note 5, at 379-80 (noting that increasing rates of derivative litigation post-1993 correlate with increased prosecution of white collar crime).

data, showing a pronounced spike in the incidence of shareholder litigation upon the lowering of filing fees, suggest that enforcement costs and related obstacles, rather than cultural values, dampen corporate law enforcement in the region. These conclusions are developed in the next two sections of the Article.

B. *Corporate Law Enforcement in East Asia: Demand and Supply*

Though difficult to measure precisely, demand for investor protection has increased substantially in Korea, Taiwan, and Japan over the past half decade. The single most important reason for this shift in demand has been the Asian financial crisis, because poor corporate governance practices are widely seen as a major contributing factor to the crisis.⁷⁶ In countries such as Korea, investor protection received virtually no attention prior to the outbreak of the crisis, but it became a leading public policy concern thereafter. While Taiwan escaped the Asian financial crisis relatively unscathed (largely due to macro-economic differences between it and the crisis countries), it encountered a spate of serious corporate scandals at the end of the 1990s, which had the equivalent effect of exposing serious problems in corporate shareholding structures and managerial oversight mechanisms. In Japan, a decade of economic malaise and a long series of problems in the corporate and financial sectors have made corporate governance reform a leading topic. Expectations toward corporate governance and investor protection have also changed as the constellation of shareholders in these countries has shifted. Both foreign institutional investment and foreign direct investment in the region have increased substantially over the past five years, bringing with them new perspectives on the proper goals and behavior of corporate management.⁷⁷

Governments in all three countries have responded to this increase in demand with a host of corporate and securities law revisions, many of which were designed to improve the position of minority shareholders. For example, minimum ownership thresholds or fees for exercising certain shareholders rights were lowered, and the fiduciary duties of directors were made more explicit. Yet despite considerable reform of corporate law, as the analysis below indicates, corporate law enforcement remains somewhat problematic, suggesting that gaps remain between demand for and supply of investor protection.

Before surveying the principal impediments to more active corporate law enforcement in East Asia, it is useful to note that the three systems share a common legal tradition. Japan transplanted basic features of the continental civil law tradition, most notably the German system, into its legal system at the end of the nineteenth century. As a result, Japan's Company Law, part of the Commercial Code, bears many structural similarities to the German Commercial Code. Moreover, the basic features of its judicial and civil

76. Simon Johnson et al., *Corporate Governance in the Asian Financial Crisis*, 58 J. FIN. ECON. 141 (2000).

77. On Japan, see Curtis J. Milhaupt & Mark D. West, *Institutional Change and M&A in Japan: Diversity Through Deals*, in GLOBAL MARKETS, *supra* note 4, at 295.

litigation systems are familiar to anyone trained in the civil law tradition. Through colonization in the early twentieth century, Japan substantially influenced the legal systems of Korea and Taiwan. Thus, with (increasingly prevalent) system-specific variations, one encounters across the three jurisdictions basic similarities in the structure of the judiciary and the legal profession, the procedural environment for civil litigation, and the overall “approach” of the Company Law to investor protection. As a result, one finds (with some variation in specifics and acuteness) common impediments to private law enforcement in the corporate area, including high standing thresholds, lack of access to information, and procedural rules that may discourage would-be plaintiffs. As a result, whether inadvertently or by design, most enforcement efforts fall to the state.

1. *High Statutory Thresholds and Economic Risk*

High shareholding thresholds for the exercise of important shareholder rights and the significant economic risks of filing suit have historically been major obstacles to shareholder activism in East Asia. In both Korea and Taiwan, until recently, minority shareholders had to collectively own 5% of the outstanding shares to file a derivative suit. Given the average market capitalization of listed companies in Korea as of 1997, for example, this requirement meant that minority shareholders had to hold, in the aggregate, over 3 billion won (\$3.5 million) in shares to file a derivative action.⁷⁸ Post-Asian financial crisis corporate law reforms in Korea reduced that threshold to 0.01% for listed firms.⁷⁹ Recent Taiwanese reforms lowered the threshold to 3% of the outstanding shares held continuously for one year, but this still poses a formidable barrier to obtaining standing.⁸⁰ By contrast, standing is not a problem in Japan, where only a single share, held continuously for six months, is required to file a derivative suit.⁸¹

Beyond meeting standing thresholds to bring suit, plaintiffs need access to corporate information in order to build a case against management. In all three systems, the corporate law poses a high bar to plaintiffs. In Japan, 3% of the voting rights are needed to inspect corporate accounts and records and to appoint an inspector to examine corporate affairs and records.⁸² The same thresholds were in effect in Korea until 1997, although they have been reduced for publicly held firms through recent reforms. While 3% of the outstanding shares are still required to appoint an inspector (1.5% for specified large companies), holders of 0.1% of the outstanding shares are now entitled to inspect books and records of public companies (0.05% for specified large companies).⁸³ In Taiwan, holders of 3% of the shares may appoint an inspector.⁸⁴

78. Kim & Kim, *Revamping Fiduciary Duties*, *supra* note 4, at 386.

79. Securities and Exchange Act, art. 191-13(1) (2002) (S. Korea).

80. Company Law, art. 214 (2001) (Taiwan).

81. SHŌHŌ [COMMERCIAL CODE] art. 267 (Japan).

82. *Id.* arts. 237(3), 293-6 (Japan).

83. Securities and Exchange Act, art. 191-13(3), 191-13(5) (2002) (S. Korea).

84. Company Law, art. 245 (2001) (Taiwan).

The cost and attendant financial risks of filing suit can also pose obstacles to derivative litigation in all three systems. In Japan, until a 1993 amendment fixed the fee at a nominal amount, most courts interpreted a procedural statute to require that plaintiffs in derivative suits pay a filing fee on a sliding scale based on the amount of damages sought. According to this scale, a \$10 million claim against management, for example, would require a filing fee of \$25,000⁸⁵—a fee that was forfeited if the plaintiffs lost. As discussed above, revision of the filing fee touched off a small explosion of derivative litigation in Japan.⁸⁶ Even today, however, upon the defendant's motion, plaintiffs in derivative suits may be required to post a bond for expenses, a requirement that was eliminated from most state corporate laws in the United States because it chilled both frivolous and meritorious suits. In cases in which the Japanese courts have granted the motion, the bond has averaged about \$1.5 million, virtually the equivalent of a dismissal of the suit.⁸⁷

In Taiwan, the financial risks of derivative litigation are even more severe.⁸⁸ Plaintiffs must advance 1% of the claim as a filing fee at the district court level, and 1.5% at both the appellate court and the court of last resort.⁸⁹ As in Japan, the loser pays court costs plus his own attorneys' fees. Thus, even if enough minority shareholders could be assembled to meet the 3% threshold for filing suit, they face the risk of huge out-of-pocket loss—up to 3.5% of the damages sought plus their attorneys' fees—if they ultimately lose the case.

Filing fees and court costs pose less of an obstacle to derivative litigation in Korea. Korean procedural law has always set the filing fee in derivative suits at a nominal amount, consistent with current Japanese law. And while Korean courts, like courts in Japan and Taiwan, are empowered to order that the plaintiff post a bond for expenses, they have not done so in the small number of derivative suits filed to date. In Korea, the losing party pays court costs including attorneys' fees, but only up to a nominal amount determined by a formula.⁹⁰ Given the low fees, it is not clear why the number of shareholder derivative suits in Korea has remained small following the drastic lowering of ownership thresholds for filing suit. Perhaps the information and access problems discussed in the next section remain sufficient to dampen litigation.

85. West, *supra* note 5, at 355.

86. See *supra* note 73 and accompanying text.

87. West, *supra* note 5, at 355.

88. Liu, *Corporate Governance in Taiwan*, *supra* note 31.

89. These fees were recently increased to 1.1% and 1.65%, respectively.

90. SUP. CT. R. 758 (Korea). However, both the Commercial Code and the Securities and Exchange Act allow successful derivative suit plaintiffs to recover actual attorneys' fees from the corporation. This rule obviously has no bearing on the plaintiff's calculation of downside risk in the event he loses the case.

2. *Weak Infrastructure for Private Law Enforcement*

Civil enforcement of corporate and securities cases in all three countries is hampered by several features common to all legal systems in the civil law tradition: the lack of a formal discovery system to aid the production of evidence, the absence of class action procedures to overcome collective action problems in litigation, and limited remedies for breach of fiduciary duty. All of these factors contribute to diminishing the incentives to file suit. These features of the procedural landscape for civil litigation are exacerbated by the structure of the legal profession in the three systems. The population of judges is low by comparative standards (see Table 1), leading to significant delay in clearing cases, at least in Taiwan. Equally significantly, the judiciary is organized as a career bureaucracy, with the only major point of entry at the bottom. This results in a dearth of judges with professional experience in corporate law or white collar crime. Judges unfamiliar with business practices, particularly those operating in the more code-bound civil law tradition, are more likely to avoid breaking new doctrinal ground in identifying unlawful conduct and fashioning flexible remedies to address contemporary corporate governance issues.

The infrastructure for private law enforcement is further constrained by low lawyer populations in general (see Table 1), small numbers of attorneys who specialize in corporate and securities law in particular, and a lack of high-powered incentive compensation mechanisms for attorneys to seek out worthy plaintiffs in corporate and securities cases.⁹¹

TABLE 1: COMPARATIVE LEGAL POPULATIONS⁹²

	United States	England	France	Germany	Japan	Korea	Taiwan
Lawyers	906,611	80,868	29,395	85,105	16,398	4,300	3,900
Per 100,000 Population	339.87	154.89	50.15	103.77	13.0	9.45	18.13
Judges	30,888	3,170	4,900	20,999	2,093	1,400	1,607
Per 100,000 Population	11.6	6.07	8.4	25.6	1.7	3.07	7.47

3. *Tradition of Shareholder Passivity*

Although the situation is beginning to change, shareholding patterns in all three systems have not been conducive to shareholder activism, either at

91. Cf. Coffee, *supra* note 68, at 669-70 (“[T]he key legal rules that make the private attorney general a reality in America today . . . are not substantive but procedural—namely, those rules that establish the fee arrangements under which these plaintiff’s attorneys are compensated.”).

92. Data for the United States, England, France, Germany, and Japan are as of 1997, and are available at <http://www.courts.go.jp/pre21/16.gif> (last visited Dec. 15, 2003). Korean data are as of 2000 and can be found in Jae Won Kim, *The Ideal and the Reality of the Korean Legal Profession*, 2 ASIAN-PAC. L. & POL’Y J. 45, 46 (2001). Taiwan data are as of 2002 and were provided to the author by the Taiwan Bar Association and the Judicial Yuan.

the individual or institutional level. In Korea and Taiwan, family-affiliated conglomerates play a major role in the economy. Founders and their families exercise disproportionate control over group firms through pyramidal share ownership structures. In Japan, although the distinct identities of *keiretsu*⁹³ corporate networks have been diluted and cross-shareholding among *keiretsu* group firms is declining, management threatened by an unwelcome advance can still mobilize friendly shareholder networks to fend off a challenger—as recent episodes of shareholder activism in Japan have demonstrated.⁹⁴ Concentrated ownership may reflect the weak legal protections for minority shareholders in civil law-style commercial codes.⁹⁵ Conversely, the law may not have developed stronger investor protections because relational shareholding patterns among affiliated firms reduced the need for them.

Domestic institutional investors thus far have not played a significant role in corporate governance in any of the three countries. This is a simple reflection of the identities and goals of the investors. As commentators have noted, for example, in Korea, “most domestic institutional investors are direct affiliates of the *chaebol* or rely upon them for business, and thus remain captive and passive monitors.”⁹⁶ Similarly in Japan, most domestic institutional investors place priority on maintaining reciprocal business relationships over increasing shareholder value. They vote, but rarely coordinate with other institutional investors on corporate governance issues, make shareholder proposals, release focus lists, or engage in other efforts to improve performance at portfolio firms.⁹⁷ In Taiwan, there is less room for institutional investor activism because the stock market is dominated by individual investors.⁹⁸ Even where institutional investors do take stakes in portfolio firms, as in the other two countries, they play a passive role in corporate governance.

Given these shareholding patterns and the passivity of institutional investors, shareholder discipline in the form of the market for corporate control is virtually nonexistent in the three systems. By comparison, in the United States, takeovers are one of the main contexts in which shareholders

93. The term *keiretsu* describes a group of affiliated companies typically organized around a single bank.

94. For example, institutional investors with stable shareholding and business ties to a firm called Tokyo Style gave unconditional support to management in a high profile proxy fight initiated by the firm’s largest shareholder. The support of these institutional shareholders allowed management to defeat the unwelcome advance. See *Institutions Threaten Corporate Governance*, NIKKEI WKLY., July 22, 2002, 2002 WL 25813719.

95. This is the principal finding of an influential line of empirical research. See, e.g., La Porta et al., *Law and Finance*, *supra* note 63.

96. Kim & Kim, *Revamping Fiduciary Duties*, *supra* note 4, at 377.

97. See KŌICHI AKAISHI, KIKAN TŌSHIKA NO KŌPŌREETO GABANANSU KATSUDŌ NO IGI—WAGA KUNI NO KIKAN TŌSHIKA WA KŌKATEKI NA GABANANSU KATSUDŌ GA DEKIRU KA [THE SIGNIFICANCE OF CORPORATE GOVERNANCE ACTIVITIES BY INSTITUTIONAL INVESTORS: CAN INSTITUTIONAL INVESTORS IN OUR COUNTRY PLAY AN EFFECTIVE ROLE?] (2002) (unpublished report, on file with The Yale Journal of International Law).

98. As of 2001, domestic institutional investors accounted for less than ten percent of the market by trading volume. Jaw Chyuan Chu, *The Taiwan Securities Market, Address Before the Organization for Economic Cooperation and Development Fourth Round Table on Capital Market Reform in Asia* (Apr. 9-10, 2002).

exercise rights, and one of the main vehicles for the creation of law on directors' fiduciary duties.⁹⁹

4. Constraints on State Enforcement

Given this litany of obstacles to private enforcement of corporate law, criminal prosecution has had to play the leading role in all three systems. Indeed, piggybacking on public enforcement has often been the only realistic means of obtaining the information necessary to pursue private litigation.¹⁰⁰ Yet heavy reliance on state enforcement of corporate and securities law via the criminal justice system and regulatory authorities can be problematic. At the most basic level, corruption and political favoritism remain obstacles to vigorous criminal and regulatory enforcement in Korea and Taiwan.¹⁰¹ Moreover, the deterrent effect of criminal prosecution is diluted by the fact that trials in Taiwan are drawn out, and in Korea, convicted white collar criminals are frequently granted amnesties by political leaders.¹⁰² While prosecutorial and judicial corruption is rare in Japan, more subtle factors diminish the effectiveness of state enforcement. For example, it is common for convicted white collar criminals to receive suspended sentences.¹⁰³ Recently, courts have justified these light sentences on the theory that corporate fraud of the type conducted by the defendant managers was widespread in the Japanese business community at the time the offense occurred.¹⁰⁴ While justifiable on some levels from an equity perspective, these

99. See, e.g., *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) (finding directorial duty to auction the company to highest bidder in certain circumstances); *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985) (finding breach of duty of care in takeover context); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985) (subjecting defensive measures to enhanced judicial scrutiny in light of directors' inherent conflict of interest in takeover situations).

100. Kim & Kim, *Revamping Fiduciary Duties*, *supra* note 4, at 390 (stating that the first derivative suit in Korean history was only possible because shareholder plaintiffs had access to information produced in criminal investigation); Liu, *Corporate Governance in Taiwan*, *supra* note 31, at 35 (noting that in Taiwan, court fees are also waived in piggyback cases); West, *supra* note 5, at 377-380.

101. See, e.g., Jong-Sup Chong, *Political Power and Constitutionalism*, in RECENT TRANSFORMATIONS IN KOREAN LAW AND SOCIETY 11, 25 (Dae-Kyu Yoon ed., 2000) ("Law enforcement organs are still subservient to political power. Political decisions give great influence to judicial interpretations."). A senior Taiwanese securities regulator publicly acknowledges that "compliance with law is often influenced by political relationships. Enterprises having good relationships with political parties have more leverage to avoid compliance with regulations." Chi-Hsien Lee, *Corporate Governance in Taiwan: Recent Developments in Government Policy—A View from Government 18* (Nov. 2, 2001) (unpublished manuscript, on file with The Yale Journal of International Law).

102. See, e.g., Chong, *supra* note 101.

103. Indeed, in 2000, suspended sentences accounted for almost ninety-four percent of the verdicts of imprisonment without forced labor. Foreign Press Center/Japan, *Japan: A Web Guide—Courts & Police*, at <http://www.fpcj.jp/e/shiryo/pocket/courts/courts.html> (last visited Dec. 15, 2003). For a recent example, see Yukijirushi (Snow Brand), 1113 HANREI TAIMUZU 284 (Kobe Chisai Saibansho [Dist. Ct.], Nov. 22, 2002) [hereinafter *Snow Brand* case] (handing down two-year suspended sentences to employees for defrauding government subsidy program by mislabeling products).

104. For example, in the *Snow Brand* case, *supra* note 103, five former corporate officials pleaded guilty in connection with a major food mislabeling scheme, public disclosure of which destroyed their firm. They received suspended two-year prison terms because the court found that while the defendants engaged in a "vicious crime that abused [the subsidy program] and betrayed people's trust," it had been a long-standing practice in the industry to falsify product information. *Snow Officials*

lenient sentencing practices, like the amnesties in Korea, significantly dilute the deterrent effect of prosecution.

C. *Explaining Cross-Country Diversity in NPO Shareholder Activism*

The three shareholder activist organizations described above share two important traits. First, though bound—either legally in the case of PSPD and the SFI, or voluntarily in the case of Shareholder Ombudsman—by the non-distribution constraint, all three organizations have overcome financial incentive problems to play a noteworthy role in the corporate governance environments of their home countries. Even in the absence of significant financial incentives, busy, talented professionals in all three systems have organized themselves into firms designed to produce public goods.¹⁰⁵ Discerning the motives of individuals operating within the non-distribution constraint is obviously difficult. An NPO is an interest group by another name, and critics of these groups see dark motives at work, such as political ambition, hidden financial rewards, careerist maneuvering, and even betrayal of national interests.¹⁰⁶ Some of these motives cannot be discounted; for example, the Korean leader of PSPD's shareholder rights group has become widely known through his activities, and lawyers may be lured to these organizations principally by the experience, media attention, and networking opportunities provided by the cases they bring. It is even plausible that lawyers working for these organizations are engaged in a kind of "loss leader" activity, creating a domestic climate conducive to derivative litigation so that they can capture the market for this legal work in the future.¹⁰⁷ It is virtually impossible to discern whether and to what extent "selfish" motives may be at work among the individuals involved in these NPOs. But other motives seem plainly to be at work as well, including altruism (in the form of a strong desire to reform negative aspects of one's society) and anger (directed at widespread, unpunished wrongdoing by powerful individuals and organizations). It seems unlikely that these groups could have attained the respect they enjoy among professionals at home and abroad if selfish motives predominated. And regardless of underlying motives, the net effect of these organizations' activities on the corporate governance environments of their home jurisdictions appears positive, though admittedly the precise effect is

Get Suspended Terms, JAPAN TIMES, Nov. 23, 2002, <http://www.japantimes.co.jp/cgi-bin/getarticle.pl5?nn20021123a3.htm>.

105. As one commentator notes of the Japanese group, "since 'Shareholder Ombudsman' effectively has no client for its activities, without strong personal incentives to participate on the part of attorneys, the organization could not have been formed." Otsuka, *supra* note 44, at 709-10.

106. For example, PSPD and the leader of its shareholder rights' movement have been castigated in some segments of the Korean media as out to overturn the country's capitalist system. See Boog-Kyu Lee, *Don Quixote or Robin Hood?: Minority Shareholder Rights and Corporate Governance in Korea*, 15 COLUM. J. ASIAN L. 345, 347 (2002). Shareholder Ombudsman's case selection has been criticized, and critics occasionally make comparisons between the group and the Japanese racketeers known to seek payoffs in return for not disrupting shareholders meetings.

107. This possibility was suggested to me by Eric Talley.

impossible to measure.¹⁰⁸ Some people do appear willing to produce public goods, at least in tandem with the pursuit of selfish motives.

Second, all three organizations use the legal system of their home country—specifically, the domestic corporate and securities laws—as the primary tool for the advancement of their objectives. This is significant because it sets these groups apart from other corporate governance-oriented NPOs, which either tend to focus on broad social issues such as the environment or largely confine their activities to information gathering and analysis. It is also significant because all three systems, to a greater or lesser degree, have been characterized in the contemporary corporate governance literature as having comparatively weak investor protections and enforcement regimes tied to their shared civil law origin.¹⁰⁹ Indeed, as this Part has shown, there is evidence to support such a characterization. Yet despite—or perhaps, more accurately, in the face of—these weaknesses, motivated individuals have organized firms between the interstices of public and private action to enforce these laws, warts and all.

These common traits, however, mask substantial differences in the formal structure, strategy, and limitations of the three NPOs in their home countries. The origin of this diversity can be traced directly to the distinctive legal, social, and historical environments in which they emerged. Consistent with supply-side theories surveyed in Part III, legal and other environments vary in their receptiveness to the NPO form, and are not equally conducive to the production of the social entrepreneurs who establish and run NPOs.

By way of example, it is instructive to compare PSPD with Shareholder Ombudsman, since the two groups have generally similar objectives. PSPD has over 12,000 members with an annual budget of almost \$1.5 million (funded almost entirely out of membership dues), and a professional staff of fifty.¹¹⁰ The PEC (the operational arm of PSPD engaged in shareholder activism) has three full-time paid staff members and about twenty volunteers. PSPD pursues a national agenda of *chaebol* reform. Toward that end, it has created a list of target companies on which to focus its efforts, hoping to make an example of Korea's best known firms. As part of this national agenda, PSPD actively pursues legislative reform, including the enactment of a class action mechanism for securities cases, through lobbying efforts. Moreover, PSPD has consciously attempted to co-opt foreign institutional investors into its program, using proxy fights and international road shows to advance and publicize its cause. And, as noted above, PSPD is associated with two historic

108. Several readers suggested that I compare cases brought by the NPOs to those brought by for-profit law firms to discern the motives of the NPOs. Based upon such a review, the cases brought by the NPOs in Korea and Japan are arguably comparatively “high profile” cases. (I was unable to make a comparison for Taiwan.) Even if accurate, however, this conclusion does not lead to unambiguous conclusions about underlying motives. It could be that NPO members are publicity seekers. It also could be that the high profile nature of the cases made them particularly suitable for their deterrent and precedent-setting effects.

109. See La Porta et al., *Legal Determinants*, *supra* note 63; La Porta et al., *Law and Finance*, *supra* note 63.

110. People's Solidarity for Participatory Democracy, *About PSPD*, <http://www.pspd.org/pspd/about/about.html> (last visited Dec. 15, 2003).

court victories, one of which came at the expense of the chairman and managers of one of Korea's most famous firms.¹¹¹

Two related characteristics of PSPD help account for its visibility, aggressiveness, and success. First, in many respects PSPD is the nonprofit equivalent of the *chaebol* it is fighting—large, highly diversified, closely associated with its founding members, and highly attuned to national politics.¹¹² Its leadership consciously avoids localized issues so as to minimize internal conflicts and to pursue its cause at the center of power—the national government and the largest business organizations.¹¹³ Second, PSPD, like other major civic groups in Korea, traces its lineage directly to protest movements against past military governments. Some of the leaders of these groups, now lawyers or other professionals in their thirties and forties, were once student activists jailed for their fight against military rule.¹¹⁴ Thus, PSPD and the larger civil movement of which it is a leading member were born directly out of social cleavages resulting from rapid economic growth under authoritarian regimes.¹¹⁵ As one commentator notes: “Long lasting authoritarian rule produced many dissidents who are advocates of public issues. As authoritarian rule receded, many activists pursued specific public interests in civic organizations The inauguration of the first civilian government in the early 1990s provided a fertile milieu for active civil movements.”¹¹⁶ Today, the Korean government actively supports NPOs. Indeed, PSPD is eligible for government funding, but declines to accept it so as not to cloud its independence.¹¹⁷

Japan's Shareholder Ombudsman, by contrast, was formed in a very different climate for social entrepreneurship. Unlike Korea, Japan has limited national experience with large, independent activist groups, partly the result of “one of the most severe regulatory environments [for NPOs] in the developed world.”¹¹⁸ This regulatory environment has provided incentives for the development of organizations that are small and local in nature, while hobbling the development of large, professional civic groups. Historically, this

111. See *supra* notes 27-29 and accompanying text.

112. The Secretary General of the PSPD has noted the criticism of his organization as a “department store” seeking to monopolize a wide range of issues. Won Soon Park, *NGO Development in Korea*, 15 SONGKONGHAE DAEHAK NONCHONG [SONGKONGHAE UNIV. J.] 49, 75 n.26 (2000). PSPD focuses its activities on the national government due to the highly centralized nature of government in Korea. See Won Soon Park, *The Role of NGOs in Transition—Centering on the People's Solidarity for Participatory Democracy (PSPD)* (2001) (unpublished manuscript, on file with The Yale Journal of International Law).

113. Interview with Won Soon Park, legal activist and co-founder of PSPD, and Kyong-Whan Ahn, academic affiliated with PSPD, in Seoul, South Korea (Sept. 24-25, 2002).

114. Laxmi Nakarmi, *The Power of the NGOs*, ASIAWEEK, Feb. 11, 2000, at 28.

115. INCHOON KIM & CHANGSOON HWANG, *DEFINING THE NONPROFIT SECTOR: KOREA* 3-4 (Johns Hopkins Comparative Nonprofit Sector Project, Working Paper No. 41, 2002).

116. Dae-Kyu Yoon, *Legal Aid and Public Interest Lawyering*, in *RECENT TRANSFORMATIONS IN KOREAN LAW AND SOCIETY* 377, 383 (Dae-Kyu Yoon ed., 2000).

117. E-mail from Joongi Kim, academic affiliated with PSPD, to author (Mar. 17, 2003) (on file with The Yale Journal of International Law); Comments from Hasung Jang, academic who leads the shareholder protection activities of PSPD, in Tokyo (Jan. 8, 2003).

118. ROBERT PEKKANEN, *AN ANALYTICAL FRAMEWORK FOR THE DEVELOPMENT OF THE NONPROFIT SECTOR AND CIVIL SOCIETY IN JAPAN* 18-19 (Nonprofit Sector Res. Fund, Working Paper Series, Spring 2001).

dichotomy reflects a conscious policy decision to limit the scope of NPO activities so that citizen efforts are not diverted from the pursuit of governmentally chosen goals.¹¹⁹

A close evaluation of Shareholder Ombudsman reveals this pattern. As noted above, at the time it was formed, Shareholder Ombudsman could not meet the financial requirement for establishment as a nonprofit membership organization [*shadan hōjin*] under the Civil Code.¹²⁰ As a result, it was organized as a limited liability company [*yūgen gaisha*]. Yet this organizational form has clear disadvantages for a civic organization. Legally, a limited liability company may have no more than fifty members,¹²¹ so most of Shareholder Ombudsman's membership is informal. As a for-profit entity in the eyes of the law, it is not eligible for tax-favored status or government subsidies. As a legal matter, its members are not bound by the non-distribution constraint, a fact which may diminish the trust it enjoys among potential members and the public as a whole. Moreover, Shareholder Ombudsman's strategy is quite "localized," at least in comparison to PSPD's national agenda. As one affiliated academic explained, the goal of Shareholder Ombudsman is not to "make law," or to directly change society, but to improve management one firm at a time.¹²² This may explain why Shareholder Ombudsman has chosen to settle most of its cases. Under a one-company-at-a-time strategy, obtaining commitments from target management to rectify their practices may be more important, and certainly less resource-intensive, than obtaining a judgment in court. All of these factors may account for the relatively low profile of Shareholder Ombudsman in Japan's corporate governance environment, notwithstanding the organization's considerable activities.

In Taiwan, as in Korea, the activist social environment and nascent democracy have been conducive to the mobilization of civil society. Yet Taiwan's SFI reflects a distinct approach to NPOs and the supply of public goods. It is a creative partnership between the public and private sectors, reflecting a conscious government strategy:

Since martial law ended in 1985, . . . [t]he government especially welcomed the establishment of foundations, viewing them as social resources ready to aid in government functions of delivering services and distributing resources to society. . . .

The current legal framework reflects a cooperative approach on the part of government, by which it intends to become involved in the goals, operations, and supervision of NPOs.¹²³

The collaborative effort between the state and an NPO to provide investor protection provides an illustration of the "contract failure" theory, with a novel twist. Recall that this theory posits that NPOs exist to provide goods or

119. *Id.*

120. *See supra* note 46.

121. *Yūgen gaisha hō* [Limited Liability Company Law], Law No. 74 of 1938, art. 8.

122. E-mail from Yoshihiro Yamada, Lecturer, Takayama Keizai University, and Masafumi Nakahigashi, Assistant Professor, Nagoya University, to author (Nov. 19, 2002) (on file with The Yale Journal of International Law). Mr. Yamada is affiliated with Shareholder Ombudsman.

123. Joyce Yen Feng, *Taiwan, in* PHILANTHROPY AND LAW IN ASIA 315, 326-27 (Thomas Silk ed., 1999).

services whose quality or quantity is difficult for consumers to evaluate. The theory predicts that where such information asymmetries are great, consumers turn to NPOs as trustworthy producers of public goods. But as the SFI illustrates, the government may also turn to NPOs to overcome asymmetric information and trust problems.¹²⁴ The NPO form provides a “layer of insulation” between the government and politically or technically problematic enforcement efforts.¹²⁵ At the most basic level, the measurement problems inherent in the supply of investor protection services renders the SFI (bound by the non-distribution constraint) superior to a contract with a local law firm to locate and organize worthy plaintiffs in securities and corporate fraud cases. More importantly, perhaps, trust in the NPO form among market participants provides the government leeway to expand its enforcement efforts into the civil enforcement realm by co-opting the SFI into its investor protection agenda, and obtaining private sector funding for those enforcement efforts.

The limitations of the SFI in fulfilling its mission seem largely unrelated to the domestic NPO environment. Rather, the costs and risks inherent in Taiwanese litigation discussed above have limited its potential as a deterrent device. One example is the *Hua Loong* case, which involved a straightforward question: is an insider who bought common stock and sold convertible preferred shares within the statutorily prescribed period captured by the short-swing trading disgorgement rules?¹²⁶ The SFI hesitated to pursue this “certain victory” in court because filing suit required payment of a NT\$10 million (\$300,000) fee. If SFI had lost the case despite its optimistic assessment of the merits, its endowment would have been devastated. Ultimately, SFI filed suit and won, but the episode shows the impact of procedural rules on enforcement decisions.¹²⁷

To address these issues, a Securities and Futures Investor Protection Law was passed in 2001.¹²⁸ The most interesting feature of the law is that it is designed principally to enhance the enforcement capabilities of the SFI. In that sense, it serves as a powerful political endorsement of the SFI’s role in corporate governance. It authorizes the establishment of an Investors Protection Foundation (IPF) to take over the investor protection service of SFI in a stand-alone foundation.¹²⁹ The Foundation’s endowment will be funded by mandatory contributions from securities and futures companies, as well as the stock and futures exchanges.¹³⁰ The IPF is prohibited from seeking compensation for its litigation activities on behalf of investors,¹³¹ thereby reinforcing the non-distribution constraint. The law also provides several

124. NPO scholar Estelle James anticipated this twist on the contract failure theory long ago. See James, *supra* note 11, at 7.

125. See Michael Krashinsky, *Stakeholder Theories of the Non-Profit Sector: One Cut at the Economic Literature*, 8 VOLUNTAS 149, 155 (1997).

126. In re *Hua Loong, Inc.*, Selected Judgments of the Major Cases Violating the Securities and Exchange Law, Vol. 2, July, 1995, at 103 (Taiwan High Court, 1993).

127. Interview with Chi-Hsien Lee, Commissioner, Taiwan Securities and Futures Commission, in Taipei, Taiwan (Oct. 16, 2002).

128. Securities and Futures Investor Protection Law (2001) (Taiwan).

129. *Id.* art 18.

130. *Id.*

131. *Id.* art. 33.

advantages to the IPF in litigation. Courts are instructed to waive the security for expenses bond posting requirement in motions for provisional relief.¹³² In the calculation of court fees, the amount of investor claims serving as the basis of calculation will be deemed not to exceed NT\$100 million (\$3.3 million).¹³³ This reduces the required filing fee and limits the court fees payable upon a final adverse judgment. Securities regulatory officials anticipate that, with these more favorable procedural rules, IPF will have a general deterrent effect on corporate managers similar to the effect of class action litigation in the United States.¹³⁴

D. Summary

The “government failure/market failure” theory helps explain why NPOs have spontaneously emerged in all three countries to address gaps in the supply of investor protection and corporate law enforcement. NPOs as providers of investor protection appear to have emerged (in the case of the Korean PSPD and Japan’s Shareholder Ombudsman) and become very active (in the case of Taiwan’s SFI) at this particular time for a simple reason: the demand for investor protection has increased significantly in Korea, Taiwan, and Japan in the past half decade, due to the Asian financial crisis, domestic scandals, stock market declines, and the more heterogeneous expectations of investors. These factors have coincided with the gradual demise of the postwar institutional structure for corporate governance (featuring heavy bank and government involvement in corporate finance) and have led to increased awareness of investor protection and corporate law enforcement as significant policy issues. Despite significant corporate law reform in each of these countries, neither government nor market mechanisms have fully responded to the increase in demand for “good” corporate governance, particularly in the form of robust enforcement. While corporate and securities law reforms have plainly improved the position of minority investors in these countries, the surrounding legal infrastructure remains relatively plaintiff-unfriendly in these cases. Moreover, there appears to be considerable public antipathy in the three systems toward allowing lawyers to play a larger role (at least for profit) in the resolution of economic problems. The emergence of corporate law-related NPOs in Korea, Taiwan, and Japan at this time also coincides with a surge in public interest in the NPO form as a tool of social and economic governance in all three countries, the end of authoritarian rule in Taiwan and Korea, and the deregulatory movement in Japan. In such an environment, the NPO is a brilliant—if partial and perhaps transitory—response to the public goods problem of corporate law enforcement.

Additionally, complementary strands of NPO theory and scholarship may help to explain why the common experience of NPO shareholder

132. *Id.* art. 36.

133. *Id.* art. 35.

134. Interview with Chi-Hsien Lee, *supra* note 127. A prominent corporate practitioner and scholar in Taiwan is more skeptical about the foundation’s ability to substitute for a more plaintiff-friendly procedural environment. E-mail from Lawrence Liu, Attorney, Lee & Li, to author (Dec. 10, 2002) (on file with The Yale Journal of International Law).

activism in the region has taken quite different forms in the three systems. For example, as noted above, the “contract failure” theory—applied to *governmental* rather than *consumer* demand—may help explain the unique role of a government-supported NPO in Taiwan’s investor protection environment. This role is consistent with Taiwan’s approach to government–third sector relations. More generally, differences in the political and legal climate for social entrepreneurship appear to account for some of the basic differences in organizational forms, strategies, and successes of the three organizations in their respective countries, and are particularly illuminating in understanding differences between PSPD and Shareholder Ombudsman. The differences among the three organizations are generally consistent with literature on both nonprofit and for-profit firms indicating that legal and underlying political differences create cross-country diversity in organizational structure and affect the supply or temperament of social entrepreneurs.

E. *Culture as an Alternative Explanation?*

Is there an alternative, cultural explanation for the emergence of this form of shareholder activism in three East Asian countries? These societies are commonly perceived to be homogeneous, and to share important religious (Buddhist) and philosophical (Confucian) traditions—traditions, it is often said, which downplay the assertion of legal rights and individual empowerment.¹³⁵ If the recent mobilization of the NPO form to enhance investor protection is an artifact of “Asian” culture, then the experience may not be replicable elsewhere.

While I do not claim that the economic theories discussed above account completely for the NPO phenomenon in East Asia, several factors suggest that the explanatory power of culture in this case is rather weak. First, recall that existing research indicates that ethno-linguistically homogeneous societies are less conducive to nonprofit activity than heterogeneous ones.¹³⁶ While Taiwan (contrary to common perception) is fairly heterogeneous on this level, Japan and Korea are very homogeneous.¹³⁷ Thus, Korea and Japan may have had to overcome ethnic and social obstacles to activate their NPO sectors. Similarly, to the extent that one acknowledges the existence of Confucian-laced “Asian values” operating in the region, they would appear to undermine the development of the NPO as a device to promote the assertion of legal rights, unless somehow the collective nature of the NPO moderates the alleged cultural distaste for individual legal action. More importantly, from my perspective, surface commonalities in religious and philosophical traditions

135. See, e.g., Amir Licht et al., *Culture Rules: The Foundations of the Rule of Law and Other Norms of Governance* 45-46 (June 9, 2002) (unpublished manuscript, on file with The Yale Journal of International Law).

136. See, e.g., Salamon & Anheier, *supra* note 57, at 232-238.

137. On a commonly used scale of ethno-linguistic fractionalization, Japan scores 1, Korea 0, and Taiwan 42, with higher scores for greater heterogeneity. By comparison, the United States scores 50 and India scores 89. See PHILIP G. ROEDER, *ETHNOLINGUISTIC FRACTIONALIZATION (ELF) INDICES, 1961 AND 1985* (2001), <http://weber.ucsd.edu/~proeder/elf.xls>.

among the three societies grow much more attenuated upon closer inspection, making it difficult to identify a common cultural variable that could account for this form of NPO activism.¹³⁸ Even assuming, somewhat counterfactually, that Buddhism is a strongly shared contemporary religious tradition in these countries, there is no evidence that a particular religious affiliation—as opposed to religious competition¹³⁹—is conducive to NPO activity.

My aim is not to rule out culture completely as an explanatory variable. The emergence of an NPO focused on investor protection in all three systems seems motivated at least in part by a visceral animosity toward the “bounty hunter” model of law enforcement prevalent in the United States¹⁴⁰—an animosity that could plausibly have cultural origins. The point is simply that culture seems far less promising as a line of inquiry for understanding the emergence of NPOs as corporate law enforcement agents in East Asia than the economic theories explored above.¹⁴¹ Perhaps even more importantly, nothing suggests that culture is so important to the story of these NPOs that their experience cannot be replicated in other regions of the world.

V. IMPLICATIONS

Understanding the role NPOs have played as corporate law enforcement agents in Japan, Korea, and Taiwan advances both academic and policy debates on corporate governance.

A. *For Comparative Corporate Governance Literature*

Two questions dominate the comparative corporate governance literature today: precisely how does law matter to corporate governance?¹⁴² And are corporate governance systems converging, specifically toward a shareholder-oriented Anglo-American model? While views are divided along several lines with respect to both debates, important areas of consensus have emerged from existing scholarship. For example, it is widely accepted that the quality of law enforcement is at least as important to “good” corporate governance as are high-quality protections for minority shareholders located in the statutory law. A second point of agreement is that in order to discern whether convergence is occurring, the concept of convergence must be disaggregated into formal and functional components. Convergence at the statutory (formal) level may not eliminate differences in practice, for example, if differences in enforcement

138. For example, there are major variations in religious affiliation across the three countries—Korea: 49% Christian, 47% Buddhist, 3% Confucian; Japan: 84% Shinto and Buddhist mixed, 0.7% Christian; Taiwan: 93% Buddhist, Confucian, and Taoist mixed, 4.5% Christian. CENT. INTELLIGENCE AGENCY, *THE WORLD FACT BOOK* (2002), <http://www.cia.gov/cia/publications/factbook>.

139. See James, *supra* note 56, at 397.

140. Consider that enactment of a class action suit mechanism and other plaintiff-friendly procedural devices in the three legal systems would arguably eliminate the need for these organizations. Indeed, Korea has just enacted a class action procedure for certain securities fraud cases.

141. See also PEKKANEN, *supra* note 118, at 15-16 (largely rejecting a cultural explanation of civil society in Japan).

142. For a recent contribution to the debate discussing many of the approaches to this question, see Stephen J. Choi, *Law, Finance, and Path Dependence: Developing Strong Securities Markets*, 80 *TEX. L. REV.* 1657 (2002).

infrastructure remain. Furthermore, functional equivalents among systems may lead to convergent effects even where significant differences remain at the formal level. Both of these points find novel and previously unexplored illustrations in East Asia's experience with NPOs as corporate law enforcement agents.

1. *Law Enforcement*

Recognition of the importance of strong enforcement to good corporate governance has prompted commentators to explore both the supporting infrastructure for effective enforcement of corporate and securities laws and to analyze functional substitutes for good local law and enforcement regimes. Bernard Black's assessment of the legal and institutional preconditions of strong securities markets is sobering, because, as he rightly concludes, the "institutions . . . at the heart of a good national investor protection system . . . are neither transplantable nor easily created."¹⁴³ Certainly it would be folly to assume that NPOs can take the place of honest and experienced courts or sound procedural mechanisms for the promotion of individual investor claims. But the East Asian experience should at least put scholars and policymakers on notice that enforcement can take novel forms. While commentators have explored a number of private and public enforcement alternatives, including writing a corporate law that consciously minimizes the need for resort to legal authority,¹⁴⁴ virtually no attention has been devoted to alternatives that lie between private and public enforcement. Indeed, for reasons explored in Section V.B, the NPO may be superior to the enforcement substitutes currently in favor in the literature.

2. *Convergence*

The NPO as a supplier of investor protection is a highly distinctive illustration of functional convergence: despite vast differences with the United States at the level of formal laws and institutions, several societies have found substitutes for the attorney-oriented incentive mechanisms and mass litigation procedural devices relied upon in the United States to enhance corporate law enforcement and investor protection. In fact, general antipathy toward such mechanisms in East Asia makes the transplantation of these procedural devices quite problematic, and probably motivated the search for a functional substitute. Neither the NPO nor the "private attorney general" ensures an optimal supply of investor protection, but these two enforcement mechanisms are distinct paths toward the same goal.

NPOs may be less effective compared to other functional substitutes for domestic enforcement, such as firms bonding themselves to "good" corporate law by listing on a foreign stock exchange that imposes high disclosure requirements and subjects listed firms to a stringent foreign (U.S.) regulatory

143. Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 UCLA L. REV. 781, 822 (2001).

144. See generally Black & Kraakman, *supra* note 1.

and private enforcement regime.¹⁴⁵ But these NPOs are inherently domestic organizations, and that attribute holds out the promise of improvement of local law enforcement institutions. By contrast, the bonding alternative may actually induce a further hollowing out of local regimes through the creation of a lemons market,¹⁴⁶ and these negative effects will ultimately reach even the firms that have “escaped” their weak home country institutions through foreign listings. As Bernard Black has pointed out, such escape is only partial: “A company’s reputation is strongly affected by the reputations of other firms in the same country. And reputation unsupported by local enforcement and other institutions isn’t nearly as valuable as the same reputation buttressed by those institutions.”¹⁴⁷ Thus, while it would be inaccurate to invest NPOs with “functional equivalence” in comparison to more market-driven substitutes for high-quality domestic enforcement regimes, NPOs hold out the unique promise of actually improving, rather than abandoning, those local regimes.

Yet the experience of East Asia with NPOs as corporate law enforcers is probably too nuanced to serve as strong support for the convergence hypothesis.¹⁴⁸ Even in their common use of the non-distribution constraint to advance the objective of investor protection, Japan, Korea, and Taiwan display striking diversity in the organizational form, strategy, and success of their NPOs. As noted above, this diversity can be traced to the distinctive legal, political, and social environments in which NPOs have emerged in the three systems. Thus, while providing anecdotal evidence of one type of convergence, the experience illustrates that “convergence” and “diversity” are extraordinarily complex concepts in corporate governance that deeply implicate domestic institutions far beyond the corporate law.¹⁴⁹

B. *For Corporate Law Enforcement in Transition Economies*

There are no obvious solutions to the under-production of corporate law enforcement in many countries around the world, other than major, long-term investments in legal infrastructure and human capital. But for a partial answer to the enforcement problem, NPOs appear to merit at least as much consideration as promoting bonding through cross-listings, writing “self-

145. See generally Coffee, *supra* note 2.

146. A lemons market describes a type of market failure caused by information and verification problems. Where buyers have difficulty distinguishing high-quality goods from low-quality goods (lemons), they will treat all goods on the market as being of average quality. Above-average goods are withdrawn from the market, prompting buyers to lower their assessment of average quality, and triggering a new round of withdrawals of above-average goods. The same downward spiral could afflict local securities exchanges if investors believe that “above-average” firms cross-list on foreign exchanges.

147. Black, *supra* note 143, at 784.

148. Academics have recently been preoccupied with the question of whether corporate governance systems are converging, specifically toward an “Anglo-American,” shareholder-oriented model. The developments in East Asia analyzed here provide two strands of support for convergence optimists. They illustrate functional convergence at work, and demonstrate new found concern for shareholder welfare in systems that at least traditionally have not been characterized as shareholder driven. Yet the NPOs in the three systems also vividly illustrate the continuing impact of diverse legal, political, and social systems on organizational structures, which is the contention underlying the position of convergence pessimists.

149. See Curtis J. Milhaupt, *Property Rights in Firms*, 84 VA. L. REV. 1145 (1998) (discussing the importance of local property rights and enforcement institutions to the convergence question).

enforcing” corporate laws, or transplanting the “private attorney general” model. In this section, I briefly outline the major advantages and problems of NPOs as suppliers of investor protection.

One benefit of NPOs as shareholder activists is that the non-distribution constraint confers a built-in safeguard against frivolous litigation. Because the enforcement agent is an organization with limited funding and a legal or reputational constraint on the distribution of profits to its controlling members, it must be very selective about the cases it pursues. The non-distribution constraint removes upside incentives to gamble on long-shot cases, and limited endowments or other sources of funding create the risk of organization-ending financial losses in the event of poor case selection. Courts may also be more inclined to trust the litigation decisions of plaintiffs represented by NPOs, so that the NPO form economizes on the use of procedural screens for litigation without merit. In these respects, nurturing NPOs to supplement law enforcement may be superior to transplanting attorney compensation mechanisms and the complementary apparatus needed to dampen the risk of strike suits.

While risk aversion on the part of NPOs may cause them to pass up some meritorious cases, as compared to attorneys, the litigation decisions of NPOs may be better from a social welfare perspective. Unlike attorneys, the members of NPOs internalize the costs of their litigation decisions (at least in the absence of government subsidies). NPOs are more likely than for-profit firms to bring cases where the principal gain from the litigation is improved corporate governance—in the form of deterrence, commitments from the firm to institute new practices, or the generation of precedent. Indeed, one important reason NPOs may have emerged in East Asia to perform corporate law enforcement functions is that shareholder litigation in the region generally has a negative net present value, for the reasons outlined in the previous section of this Article. Only an NPO, operating with non-financial motives, would take on such cases. By contrast, for-profit firms bring shareholder lawsuits in the United States because financial payouts are a likely (and perhaps often the exclusive) gain from the litigation.

Another benefit of the NPO as supplier of investor protection is that it leaves open the possibility of improvement in both government and market alternatives, and may in fact spur such improvements. The NPO can be viewed as a transitional device that may be competed out of existence when alternative supplies of law enforcement public goods are developed. Direct shareholder activism and corporate law enforcement by NPOs is not seen in the United States and the United Kingdom because it is not needed. The Shareholder Ombudsman’s role in the Japanese corporate governance environment seems limited in part because there is less need for such an organization in Japan than in Korea and Taiwan. There may come a time when the shareholder activist NPOs of Japan, Taiwan, and Korea will wither away or pursue other objectives as the investor protection environment improves or as for-profit enforcers (attorneys) take over a larger share of the market.

Finally, as noted above, NPOs are a distinctly local approach to improving the quality of law enforcement. Unlike “self-enforcing” models of corporate law or cross-listing on foreign exchanges by local firms, NPOs seek to use and improve, rather than escape, domestic enforcement institutions. This discussion is not meant to suggest that the NPO model of corporate law enforcement that has emerged in East Asia is inherently superior to the “bounty hunter” model relied upon in the United States. Rather, the point is that the two models have emerged in response to quite different enforcement environments. Both models have their limitations, and the role of NPOs in East Asian corporate governance should not be overstated. Each of the three organizations has achieved a measure of success in its home jurisdiction. But substantial gaps remain in the enforcement of corporate and securities laws—gaps that probably cannot be filled solely by NPOs. The problems with the nonprofit form are well recognized; “voluntary failure” is as palpable a phenomenon as “government failure” and “market failure.”¹⁵⁰ Many NPOs tend to be chronically short of funding because “they must rely largely upon donations, retained earnings, and debt for capital financing, since by definition they do not issue equity.”¹⁵¹ Due to funding shortages, NPOs pay only modest, if any, salaries to their professional staffs. Thus, expertise also tends to be in chronically short supply.

Moreover, the governance of NPOs themselves can be highly problematic. There are several reasons to believe that agency problems are most severe in nonprofit firms, since many of the constraints operating in the for-profit economy are missing from the NPO environment. As one commentator notes:

[I]n the nonprofit world, owners are not well-defined; their voting rights are questionable or non-existent; charitable goals are ambiguous, or at least difficult to quantify; no significant second-order markets operate; and the residual claimants are either unable to monitor effectively or unwilling to do so. . . . There is no market for corporate control; there are no proxy battles, no shareholder derivative suits, and there is very little market competition.¹⁵²

Given these serious limitations, the NPO form should best be viewed as an early stage or supplementary supplier of investor protection, particularly in transition economies, rather than a full-scale substitute for development of good public and private enforcement institutions. Thus, in East Asia, for example, creating better market-oriented mechanisms for the private supply of enforcement services—such as through the introduction of class action and civil discovery systems, and enhancements in the number and business background of judges and lawyers—properly remains on the agenda of all three countries discussed.

150. Lester Salamon, *Of Market Failure, Voluntary Failure, and Third-Party Government: Toward a Theory of Government-Nonprofit Relations in the Modern Welfare State*, 16 J. VOLUNTARY ACTION RES. 29 (1987).

151. Hansmann, *supra* note 6, at 877.

152. Geoffrey A. Manne, *Agency Costs and the Oversight of Charitable Organizations*, 27 WIS. L. REV. 227, 227-28 (1999). *See also* Harvey J. Goldschmid, *The Fiduciary Duties of Nonprofit Directors and Officers: Paradoxes, Problems, and Proposed Reforms*, 23 J. CORP. L. 631 (1998) (discussing the lack of accountability and poor corporate governance in the nonprofit sector).

The potential of NPOs in corporate governance seems most promising in the People's Republic of China. Until very recently, private investors had virtually no recourse against management for losses resulting from fraudulent corporate activity. While China's highest court recently issued rules allowing investors to sue companies for misleading securities disclosures, observers are skeptical of the impact of this development on corporate governance because of the prohibitive cost and time-consuming nature of litigation in China, as well as other institutional weaknesses in the law enforcement system.¹⁵³

Yet commentators have begun to recognize the potential of NPOs in advancing the rule of law in China. One study argues that while NPOs in China remain highly constrained by the political, regulatory and social climate, they can play a role in law enforcement.¹⁵⁴ Given that the government itself seems committed, at least within certain parameters, to a healthy corporate governance environment, a Taiwan-style partnership between the state and a corporate law enforcement-oriented NPO seems highly feasible, at least where such activities do not have overtly political overtones, such as exposing corruption in state-owned enterprises or targeting the most high-profile firms. China already has a state-sponsored NPO in the consumer protection area that could serve as a model for a nonprofit shareholder protection organization.¹⁵⁵ The NPO form may have potential in other transition economies as well, and a principal motivation for this Article was to spur examination of that possibility in other regions of the world. The notion of nonprofits as suppliers of investor protection is not novel in other systems suffering from low-quality corporate law and governance. For example, in Russia, a former securities regulator founded the Institute of Corporate Law and Corporate Governance.¹⁵⁶ The Institute provides legal consulting services and has created an index to measure the quality of corporate governance among major Russian firms to enhance investment and voting decisions among investors.¹⁵⁷ But the activities of this organization are less direct than those of its East Asian counterparts, as it does not seek to become an investor itself in order to exercise shareholder rights. Drawing on the East Asian experience, organizations such as this might possibly make even larger contributions as

153. See, e.g., Walter Hutchens, *Private Securities Litigation in China: Material Disclosure About China's Legal System?* (Aug. 24, 2003) (unpublished manuscript, on file with The Yale Journal of International Law).

154. See C. David Lee, *Legal Reform in China: A Role for Nongovernmental Organizations*, 25 YALE J. INT'L L. 363 (2000).

155. See *id.* The organization is the China Consumers' Association, which performs quasi-regulatory functions under the supervision of state agencies. This group is a so-called *banguan*, *banmin* (half-state, half-citizen) entity, which seeks to influence legislation, conducts inspections, handles consumer complaints, and advances consumer education. See Yuanyuan Shen, *Consumer Rights Protection in China's Transformation from Plan to Market* 221-35 (1998) (unpublished J.S.D. dissertation, University of Wisconsin Law School) (on file with The Yale Journal of International Law). The Consumers' Association seems like a very promising model for a "half-state, half-citizen" Chinese corporate governance organization.

156. See *supra* note 8.

157. See The Institute of Corporate Law and Corporate Governance, *CORE-rating and Reviews*, at <http://www.iclg.ru/enrating> (last visited Dec. 15, 2003).

corporate governance activists by becoming more directly involved as corporate law enforcement agents.

If the East Asian NPO activity has been a successful supplement to corporate law enforcement and improvement in the corporate governance climate in those systems, a crucial question follows: can the model be replicated elsewhere? Or to put the question in the form presented in the Introduction, why is the phenomenon of corporate law enforcement by NPO shareholder activists not witnessed more widely around the world?

In order for NPOs to work in the investor protection area, an elusive alchemy of factors must come together: rising demand for investor protection that is neither adequately met by the state through legal reform and improved enforcement, nor by private initiative; a supply of adequately trained social entrepreneurs to do the work; a local climate that is not hostile to their efforts; and at least moderately effective courts and other legal mechanisms to effectuate corporate law enforcement. Some countries have large and active NPO sectors, but corporate law-related public goods are supplied sufficiently by the state and the private sector, eliminating the need for NPO action in the area. The United States is perhaps the best example. Other countries have considerable government and market “failures” in the production of corporate law-related public goods, but the legal, political, and social climates are not conducive to the formation of NPOs. China may be an example—though, as noted above, there is reason to be optimistic about the potential role for an NPO in Chinese corporate governance.¹⁵⁸ Perhaps elsewhere, such as transition economies, NPO supply and demand conditions are ripe, but the legal machinery is simply inadequate to the task of investor protection by any actor. Thus, the East Asian experience may be the manifestation of a fortuitous, fleeting—and hard to replicate—alchemy.

But a more optimistic perspective is also possible. Because different jurisdictions approach NPOs from different legal, regulatory, social, and institutional frameworks, there seems to be no single “recipe for success” in creating investor protection organizations and no single audience elsewhere to whom the positive East Asian experience should be directed. It appears that NPOs exhibit considerable organizational isomorphism, replicating broader traits of local conditions. Thus, depending on local conditions, government regulators and enforcement authorities, legal and finance professionals, or the local investor community may play the lead role in such an organization. From the East Asian experience, for example, it appears that both “grass-roots” and “government-affiliated” organizations can play a useful role, depending on the prevailing conditions in the local system. Nor is one type of organization inherently superior to another. A government-affiliated investor protection NPO such as Taiwan’s SFI may lack a degree of political independence, but is likely to be better funded and staffed than organizations such as PSPD and Shareholder Ombudsman which assiduously avoid ties with the government. The one common essential ingredient in all three NPOs appears to be a core group of devoted professionals willing to contribute time

158. *See supra* notes 153-155 and accompanying text.

and expertise to the creation of investor protection as a public good. For that, corporate law enforcement and good governance probably must be viewed as a high priority, not only for the benefit of the investment community, but also for the improvement of society as a whole.

With a better understanding of the East Asian experience, appropriate audiences elsewhere may derive lessons useful to their own local environments. That, in any event, has been a principal motivation for this Article.

VI. CONCLUSION

High-quality enforcement is one key to good corporate governance, yet it remains an elusive goal in many countries. To date, virtually all commentators grappling with this problem have focused their attention on conventional enforcement tools—attorney-incentive mechanisms, cross-listing on foreign stock exchanges, and market-oriented gatekeepers. Yet the activities of nonprofit organizations in the three largest market economies of East Asia indicate the potential for other creative solutions to the under-production of corporate law enforcement that afflicts many economies.

While we lack a complete theory to explain the emergence of producers of public goods in corporate governance, existing theory on the role of NPOs deepens our understanding of the East Asian experience and can possibly allow us to leverage that experience for reform efforts elsewhere. As sensible extensions of existing theory would suggest and the evidence from East Asia confirms, nonprofit organizations of various types can play an important, if supplemental, role in corporate law enforcement. This is particularly true where political or ideological constraints put brakes on the development of attorney-centered mechanisms resembling those heavily relied upon in the United States. To be sure, NPOs suffer from their own weaknesses and appear to flourish only in certain social and legal environments. Yet where NPOs can be activated to provide investor protection, they may provide a solution to the under-production of corporate law enforcement that is superior to the “private attorney general” model so heavily relied upon in the United States, because the non-distribution constraint is a built-in check on over-enforcement. And because the NPO seeks to use and improve the local enforcement regime, it avoids the lemons problem inherent in solutions that bypass weak domestic institutions. As such, NPOs deserve consideration as transitional or supplemental corporate law enforcement devices in many countries around the world. Fostering an environment conducive to NPO formation, and developing creative partnerships between government agencies and nonprofit organizations for the betterment of corporate governance, seem more feasible than transplanting class action mechanisms and attorney incentive schemes from the United States—and are at least as worthy of consideration as trying to write self-enforcing corporate laws for numerous countries.

Careful examination of the nonprofit experience in this region also illustrates the complexities inherent in the question of whether national corporate governance systems are converging. On the one hand, the three largest market economies in East Asia, experiencing similar economic and

social trends, have spontaneously converged on a distinctive corporate law enforcement mechanism to address similar gaps in their public and private infrastructure for investor protection. As such, this development is a novel illustration of functional convergence with U.S. enforcement mechanisms. Delving deeper into this important point of convergence, however, one discovers great diversity in organizational form, strategy, and the relationship between the nonprofit organization and the state—differences intimately linked to the distinctive political and social structures in which these novel forms of investor protection emerged.

